Kanturk
Credit Union Limited
IRELAND

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Subject: Kanturk Credit Union Limited - Response to Consultation Paper 88

General Comment

Kanturk Credit Union Limited (KCU) broadly welcomes some of the concessions made in CP-88 following the CP-76 feedback process. Credit unions have been working hard over the past year to implement the new additional requirements required under the Credit Union Act 1997, (as amended) (the Act). This challenge has been met head-on by many credit unions at a time when demand for consumer credit is at depressed levels, interest rates are falling and the majority of the country's banks have been subject to some form of taxpayer-bailout.

The sector has proven relatively resilient with the vast majority of credit unions weathering the post-Celtic Tiger storm that led to an environment of increasing arrears and depressed loan demand. Despite issues relating to loan book performance, credit unions have, with few exceptions, kept members' savings safe and will continue to do so if facilitated by regulatory authorities.

The Act's new governance framework, once fully embedded, will assist credit unions in maturing and developing over the coming years. Progress has been made on a wide range of fronts since the publication of the Final Report of the Commission on Credit Unions, and it is important for the Central Bank and the Registry of Credit Unions to apply a fair and balanced approach to the regulation of credit unions who do so much to benefit ordinary people in communities like Kanturk the length and breadth of the country.

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

KCU welcomes that the approach to the regulatory reserve ratio remains largely unchanged from the levels introduced in 2009, notwithstanding the lack of rationale for the continued imposition of a 10% regulatory reserve ratio to all credit unions.

However, KCU does not agree with the proposal to commence the new s.45(5) and the requirement for a credit union to have a reserve in addition to the regulatory reserve requirement that it has assessed is required for operational risk having regard to the nature, scale and complexity of the credit union.

Unlike other financial institutions credit unions already have to strictly adhere to a minimum regulatory reserve requirement of 10%. However, it seems arbitrary to insist that an additional reserve for operational risk is maintained by credit unions, particularly with very little guidance being provided as to how a credit union should determine the percentage of total assets at which such a reserve should be set. Additionally, operational risk has, to our knowledge, been insulated to-date by the current 10% regulatory reserve ratio; we believe that this should remain the case. Credit unions with specific operational issues should be dealt by other means under the Act rather than through the imposition of unnecessary reserve requirements on all credit unions.

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Furthermore, s.55(1)(o) of the Act already requires that credit unions have in place a reserve management policy, which more than adequately facilitates a credit union board of directors in prudently managing the reserves of their credit unions, including any reserve 'buffers' that a board may wish to adhere to for risk management purposes.

Finally, s.76E of the Act, and the guidance issued by the Central Bank in the Credit Union Handbook under this section, imposes considerable risk management requirements on credit unions in relation to operational risk. This should alleviate the necessity for credit unions to tie up additional funds in a perpetual operational risk reserve.

The increasing cost of regulation is disproportionately punitive for credit unions; in addition to statutory levies and governance costs, reserve and liquidity requirements further tie up resources and reduce a credit union's ability to generate income – the Central Bank should be mindful of this when introducing additional reserve requirements.

It is also our considered view that a risk-weighted approach to reserving should be introduced for Irish credit unions in line with international best practice. This sort of approach is implemented effectively by the PRA in Northern Ireland, and to our knowledge, there is no credit union movement in any other jurisdiction subject to such a one-size fits all approach to regulatory reserve requirements.

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

We broadly welcome the expansion of the assets that qualify for the definition of liquid assets in calculating a credit union's minimum liquidity ratio. This more flexible definition will ensure that a credit union's accessibility to liquid assets is considered in the context of the various access arrangements that may be available with banks and other deposit-taking institutions.

However, the Central must open up discourse with deposit-taking institutions to ensure that they are amenable to providing credit unions with written guarantees for short-term access where appropriate.

The proposed short-term liquidity requirement would not be difficult to achieve for Kanturk Credit Union presently, but we disagree with its introduction in principle, notwithstanding the ease with which most credit unions would be able to comply with such a requirement. Without being privy to the Central Bank's underlying rationale for requiring credit unions to maintain such a high short-term liquidity ratio we are not even in a position to understand why access to such short-term funding would be necessary.

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

We broadly welcome the draft lending regulations, but not without some reservations, particularly in relation to the proposed concentration limits, which would restrict the future development of the Irish credit union movement.

Successful credit union movements around the world such as in North America and Australia have achieved their success by generating surpluses from lending activities that Irish credit unions tend not to engage in to any significant level. Some of the categories newly defined in the draft regulations are areas of lending in which credit unions in other jurisdictions compete directly with banks. In the medium-long term, it is probable that credit unions will be the only remaining indigenously owned community-based organisations providing loans to people across the state, and as such it is important to provide an environment in which credit unions can develop the capacity to compete directly with the for-profit banking sector.

With this in mind we believe it is important for the regulatory framework to facilitate the development by credit unions of mechanisms to openly compete with banks in areas such as mortgage and commercial lending. This could be done through a shared-service approach at a local or industrial level or it might be achieved through alternative vehicles such as centrally through representative bodies such as the Irish League of Credit Unions, who already provide credit unions with centralised solutions for the provision of member insurances (ECCU) and electronic payments (CUSOP).

Categories of Lending

We welcome the decision to introduce definitions for different categories of lending. This provides clarity to credit unions on the various delineations between types of lending activities – clarity which has been absent in the regulatory framework for credit unions until now. This clarity should assist boards and management in aligning their credit unions' strategic plans with clearly defined credit risk appetites, as well as providing a framework for the development of more advanced business-models in credit unions that have, or wish to develop such a capacity, notwithstanding the restrictive concentration limits contained in the draft regulations.

We suggest that the vast majority of lending by credit unions in the coming years will remain in the personal lending market, but it is important to acknowledge that some credit unions already do and would like to continue offering loans to finance SME's, house purchases and community development. It should be within the remit of the boards of credit unions to determine lending concentration limits for different loan categories.

Again, as with the one-size fits all approach to reserves, the application of standardised category concentration limits for all credit unions would result in the elimination of discretion for boards to grow and develop their credit unions in line with their common bonds and risk appetites. This would amount to the micro-management of credit unions by the Central Bank, a situation that could only hinder the development of the movement in Ireland.

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In relation to particular category definitions:

- House Loans

We believe that there is reasonable scope for credit unions to provide housing loans to members in a manner consistent with sound risk management practices. The huge fall in property prices since 2008 has resulted in a considerable number of properties going to market in our common bond in the €60,000 - €150,000 price range. With adequate security the net risk to the credit union were it to take on a portion of these loans would be low.

Additional internal risk management controls could facilitate credit unions in entering the market for low net-value mortgages, particularly the introduction of increasing loan-to-value on a sliding scale for loans above a certain value, which would complement the new mortgage rules announced by the Central Bank.

Furthermore, credit unions with greater scale and more sophisticated business models should be permitted to develop areas such as mortgage and commercial lending if they are prepared to put in place the required controls and personnel either in-house or through a shared service arrangement.

However, we strongly disagree with the proposal to include home renovations and improvements within the scope of the definition for house loans.[1] The inclusion of part (b) of the definition would do untold damage to credit union loan books for no discernible reason. If this regulation were to be commenced it would result in the arbitrary situation whereby a credit union would have to hold the first legal charge secured on the property for all loans granted for home-improvements, be it for a €100,000 house extension or a €5,000 redecoration of a single room. The obvious effect of this is to further and unnecessarily restrict credit unions' ability to grow their loan books.

We also take issue with the requirement in draft regulation 16 for credit unions to obtain the first legal charge over a property for which a house loan is granted. This requirement would impose huge restrictions on credit unions to compete in this market, particularly in relation to a house loan under part (b) of the definition. It would be practically impossible for a credit union to secure a legal charge on a loan issued, for example, to a member for the purpose of building an extension, since in the vast majority of cases the first charge on that property would be held by the member's mortgage lender.

- Commercial & Community Loans

We broadly agree with the proposed draft regulations in relation to commercial and community lending.

However, we believe that the concentration limits should be flexible to allow for the development of commercial underwriting capabilities on a shared basis between likeminded credit unions.

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[1] A house loan is defined as a loan made to a member secured by property for the purpose of enabling the member to: ... improve or renovate a house on the property that is already used as their principal Residence.

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Concentration limits should be related to a credit union's ability to underwrite a particular type of lending and there should exist some mechanism for credit unions to enter into discussion with the Central Bank to explore the prospect of engaging in more wide-scale commercial lending to local businesses where appropriate. This would be particularly beneficial to local economies and could lead to a freeing up of credit for indigenous businesses.

Large exposure limit

We have no problem with the large exposure limit proposed; however we acknowledge that there may be credit unions with sufficiently robust underwriting and risk management capabilities that could make loans for a value greater than 10% of the regulatory reserve.

Related party lending

KCU welcomes the decision to not introduce the proposed limit on the aggregate of lending to restricted persons at the greatest of 5% of regulatory reserves or €200,000 as was proposed in CP-76. However, we still view the proposed related party lending regulations as they appear in the draft regulations as an unjustifiable attack on Irish credit unions.

Draft regulation 19, in our view, is more than adequate to ensure that there is an appropriate approach to the provision of loans to the family members of directors or members of management in credit unions. Whilst we appreciate that the Central Bank may wish to protect against the risk of a tiny minority of credit unions potentially engaging in risky lending to related parties, the proposed mechanism is arbitrarily punitive. Furthermore, the new governance framework incorporating risk management, compliance and internal audit functions should alleviate any regulatory concerns in relation to potential risks surrounding the provision of loans to related parties, and provides for a robust level of monitoring - internal and external - of credit unions' lending functions.

If the Central Bank intends to introduce the related party lending regulations as currently formulated, we have grave concerns over the scope of the definition of related parties. The proposition to impose penalties on a director or manager's father, mother, spouse or civil partner, cohabitant, son, daughter, brother, or sister, just because they happen to be related to a person who works or selflessly volunteers in a local not-for-profit organisation seems wholly unreasonable and we would call upon the Central Bank to reconsider such a move.

These regulations raise huge practical issues for us as local lenders at the heart of our communities, and would in our view, contribute to damaging the reputation of credit unions in this country. In a small, close-knit community like Kanturk such requirements would lead to situations where the brothers, sisters or adult children of directors are told in our office that they can apply for loans but that their applications would be subject to special approval and would have to wait until a Board or special committee meeting. This is wrong. Why should a person be subject to unfair treatment purely because of a relationship that he or she has no control over?

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We also have concerns with regards to data protection and the need to process a member's data to determine who he or she might be the sibling of, co-habiting with or otherwise related to. Intrusive data collection of this type would be a cause of probable concern for the Data Protection Commissioner and is not something that other financial institutions are obliged to do; it also further weakens the attractiveness of borrowing from credit unions.

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

KCU broadly welcomes the draft investments regulations as they do not add additional layers of regulation that would further inhibit a credit union's ability to generate a reasonable return from its investment portfolio on behalf of its members.

At a time of record-low interest rates and a marked fall in investment yields expected across the sector it is heartening to see a regulatory approach that does not further restrict potential income-generating strategies for credit unions, as we try to address loan book stagnation and effectively implement strategic plans.

We also welcome the new maturity limits for investments as they afford credit unions a greater deal of flexibility in ensuring investment portfolios are managed in a balanced way.

However, we believe that the draft regulations are currently too restrictive in nature and do not facilitate credit unions in developing and diversifying their investments in the future. We would suggest that the list in draft regulation 25 be amended to include:

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

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

The introduction of a cap on savings is penal and anti-competitive, and to our knowledge no other deposit-taking institution is limited in such a way. If a member of a credit union is content to keep his or her savings in the credit union then it is wrong to force him or her to do otherwise. The effects on credit union balance sheets may not be seen for some time due to the current business environment, but such an arbitrary cap could have huge ramifications down the line when credit unions are trying to fund the growth of their loan books. There is also the reputational risk attaching to such a cap which could have an effect for the movement as a whole.

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We also would question the decision to propose a cap of €100,000. Setting a restriction on savings at a level equal to the maximum deposit guaranteed under the Deposit Guarantee Scheme, whether intentionally or not, suggests that credit unions are somehow systemically unsound. It also implies that any savings held in a credit union above this cap are inherently more at risk than deposits held in other institutions. It would be hugely undermining for a credit union to have to advise a member that it can accept €100,000 in savings, but that for amounts above this they would have to take their money elsewhere.

The application of this regulation retrospectively is also a cause of concern. Where a member holds in excess of €100,000 in shares, a credit union will have to advise him or her to withdraw the difference and place it on deposit elsewhere. This would most likely result in the member withdrawing the full amount and ending his or her relationship with the credit union.

Also, in practical terms, where a member does decide to leave the maximum amount permissible in shares in a credit union, the credit union would have to impose a lower limit to factor in the accrual of dividends. Monitoring such accounts to ensure compliance with the cap could prove cumbersome.

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

The programme of change for credit unions over the past number of years has been huge. In order to allow for the new governance requirements to fully embed we would propose pushing out introduction until financial year-end 2015/16. This would also allow the Bank to align the PRISM framework with the proposed draft regulations as well as gauging the effects restructuring is having on the sector.

Furthermore, the introduction of FRS-102 will be placing additional pressure on credit unions, which would be exacerbated by the parallel introduction of these new regulations.

Yours sincerely,

Michael Walsh
Chairman