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Introductory statement by the Registrar of Credit Unions

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at the Oireachtas Committee on Finance, Public Expenditure and Reform, and Taoiseach

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Good morning and thank you for the invitation to appear today. As you know, our statutory mandate is to ensure the protection by each credit union of the funds of its members, and to maintain the financial stability and well-being of credit unions generally.

I want to start by acknowledging the important role which credit unions play in Irish society and in the financial system, and the strong voluntary and community ethos of the sector.

My statement will focus on three main areas:

1. The current position of and main challenges facing the credit union sector;
2. The standards the Central Bank requires of credit unions, so that members' funds are adequately protected; and
3. The need for transformation in the sector to enable it to remain sustainable into the future, drawing on priorities raised in the Credit Union Advisory Committee (CUAC) 2016 Review, with which you are all familiar.

1. Profile of and challenges facing the sector

Over the past decade, credit unions have dealt with the effects of financial crisis, increased competition, major business model challenges, significant restructuring and increased regulation. From 428 credit unions in 2006, today there are 281 active credit unions – and a further c.27 mergers in progress - with sector assets at €16.1 billion. This unprecedented level of restructuring, significantly facilitated by the Restructuring Board, and Registry actions, was made possible by huge effort across the sector to safely conduct so many transfers, while ensuring continuation of services and safety of members' funds.

The sector has changed shape significantly, with more large (50 credit unions above €100m in size, representing half of sector assets) and fewer small (115 below €25m; 10% of sector assets), although levels of resilience vary widely.

At the Registry, we have prioritised regulation and supervisory changes that improve credit union safety and better position the sector for the future. The decisions we have taken included:

- strengthening the regulatory framework (as recommended by the Commission on Credit Unions, 2012);
- restrictions on lending – to contain losses - and their later removal where appropriate;
- broader onsite engagements with credit unions to focus on strategic planning, governance, risk management and controls;

- restructuring, to support needed transformation; and
- resolution of the weakest credit unions without loss of members' funds.

The combined effect of these measures, and appropriate actions by many credit unions over a number of years - to conservatively provision distressed loans, cut dividends, embed regulatory requirements and implement mergers – have, alongside economic recovery, better placed the sector to deal with its challenges.

But significant challenges remain. The biggest challenge is how to grow core loan income and volumes responsibly, following falls of over 40% in both since 2008. Net lending is only marginally recovering after seven years of decline. This core lending weakness reflects prolonged deleveraging by households and small businesses; increased competitiveness in the short-term unsecured lending market, and credit union-specific structural factors such as ageing (saving) membership and difficulties in changing business offerings to attract younger borrowers, via different channels which often require technology investment that smaller credit unions, in particular, struggle to deliver.

Investment income, which helped offset some of the declining loan income for a number of years, is also falling in the low yield environment, while cost-to-income ratios are increasing. All these factors put pressure on long term viability. Analysis by the Registry highlights that, if current loan, investment income and cost trends continue, an increasing number of credit unions could face serious viability issues in three years' time – highlighting the urgent need to now address the business model challenges the sector faces.

2. Required standards

Our onsite engagement with credit unions is prioritised by risk and impact (size), and we adopt a proportionate approach – aimed at deriving the benefits of tiered regulation. Higher standards are expected of larger, more complex entities, and there are simpler expectations on smaller credit unions, but with a minimum standard for all to ensure safety of members' funds.

We also use differentiated application of common regulatory rules as a way to achieving benefits of tiering, while accommodating the changing shape of the sector.

Regrettably, standards of regulatory compliance are still well below those required to credibly safeguard members' funds and position credit unions to tackle business model development. We are still seeing an unacceptable number of credit unions failing to display strategic understanding and good governance. In several cases, we have encountered limited financial skill sets and weak management; poor systems of control; weak risk, compliance and internal audit functioning; and weaknesses in credit practices. For example, we encountered several cases of problems with the most basic financial requirements, including bank reconciliations.

We also conduct thematic reviews, which in 2016 covered "***Outsourcing***" and "***Fitness and Probity***". Given the inevitable trend towards shared services in the future, outsourcing will be increasingly important. But the main findings on ***Outsourcing*** were that the level of understanding and compliance has not kept pace with regulatory requirements in this area. On "***Fitness and Probity***", there were several cases of minimalist compliance and limited demonstration of quality and completeness of due diligence on prospective role holders.

It is the responsibility of boards of directors of credit unions to ensure appropriate control, direction and management of their credit union, and that risks are identified, monitored and mitigated. We have communicated our expectations and findings to the sector, including that credit unions must meet regulatory requirements for their current business, before embarking on riskier ventures. We have also demonstrated – and will continue to show - our willingness to take serious actions - including enforcement, restructuring and liquidation - to ensure credit unions adequately safeguard their members' funds.

3. The need for transformation

Our view of a thriving credit union sector is one that is financially strong, provides choice and inclusion in the financial system, and carries out its important community role while meeting regulatory requirements. To get from where the sector is now to where it needs to be requires, in our view, four main changes:

I. Drive for younger active borrowers, to increase core lending

II. Derive benefits from restructuring;
III. Develop the business model in a multi-step, risk-managed way, and
IV. Increased sectoral leadership, and co-operation on shared services.

The drive to attract and retain active borrowers is critical to the sector's future. We have urged the sector to consider how to leverage its community advantages and trusted brand to a new generation of borrowing members, while pricing appropriately for risks and services and meeting regulatory requirements. Some credit unions have used low-cost but effective member-profiling and targeted marketing to attract members, which together are an important starting point.

On business model development, it is the responsibility of the sector to set out its vision and plans, and our responsibility is to challenge these for risk, affordability, relevance and possible regulatory change. We are concerned at the absence of a coherent future path supported by appropriate proposals, and at the length of time it takes for proposals to develop and mature, and we have called repeatedly for more sectoral leadership in this area.

There has been some criticism – as expressed to CUAC in their Review - that the Central Bank holds back development. We disagree with that. Firstly, the reality is that we have not received any applications or proposals for long term lending that are sufficiently well-structured and have sustainable aims. We engage extensively with the sector, in different fora, to better understand long term lending aims, and to ensure that evolving proposals address potential investment costs; projected impact on Return on Assets (RoA) over time; shared services arrangements for costs and capabilities; the changed funding arrangements needed to manage the longer term risks; how to manage collateral and legal aspects; and meet the evolving regulations, both domestic and international, that consumer mortgages require.

Second, as we indicated in the CUAC Review, we are willing to consider amending the long term lending limits. But we require clarity on credit unions' plans for prudently developing longer term lending, addressing the points above. Given the sector's current capabilities, any increase in mortgage lending would be likely to (i) require changes on funding maturity, to deal with balance sheet risks and (ii) be restricted to the most capable and financially-sound credit unions, before extending further. Again there is need for greater sectoral leadership and a fuller understanding of risks involved, to develop the roadmap of business model development.

For our part, the Registry has provided guidance and analysis, through our Stakeholder Dialogue Forum and bilateral engagements, on potential impacts of long term lending changes. We have also undertaken to publish, within coming months, enhanced guidance on what we expect to see addressed in long term lending proposals.

In addition, we have taken a range of measures to support the sector's efforts including, in 2016, the establishment of a new Business Model Development unit to drive forward better-developed proposals; to approve suitable proposals (eg, Members' Payment Current Account Services); and to develop a package of guidance on our expectations – for current accounts (published), mortgage lending and Additional Services applications (forthcoming). These measures will, we believe, be particularly beneficial for smaller credit unions, for whom it is more costly and difficult to tackle the many issues involved.

Overall, it is worrying that sectoral engagement on changing lending limits has polarised to mortgages, rather than on a diverse lending portfolio. We have not seen any investigations of other short- and medium-term lending proposals, that would build on existing capabilities and balance sheet management.

An important additional proposed business model development is providing funding for social housing. As we have indicated publicly, we will shortly consult with the sector regarding changes to investment regulations, to accommodate investments in social housing subject to term limits.

Regarding CUAC's 2016 Review, we welcomed the establishment of and participated in the Group and look forward to contributing to the Implementation Group, where we are represented. Our submission to the Review highlighted our views on the main issues, including tiered regulation and long term lending – referred to earlier – and also on common bond considerations. Regarding its recommendations on consultation and engagement, we welcome the focus on enhanced engagement between the Registry and the sector - which is already a central part of our business model support role mentioned earlier.

It has been a challenging period for credit unions, and I would like to acknowledge the constructive engagement of individual credit unions, representative bodies and other stakeholders, as we work to improve the sector's current and future state. The most important challenges are to meet current regulatory requirements – which are there to safeguard members’ funds - and to drive clear development plans while retaining the sector’s important voluntary ethos and community spirit.

Thank you.

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