Introductory statement by the Registrar of Credit Unions, Anne Marie McKiernan, at the Oireachtas Committee on Finance, Public Expenditure & Reform

16 December 2015

Good afternoon ladies and gentlemen.

Thank you for the invitation for my first attendance at your Committee since my appointment as Registrar in September 2014. I am accompanied by Deputy Registrar Elaine Byrne. As you know, our statutory mandate is to carry out credit union regulation and supervision, with a view to 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 welcome the opportunity to discuss the current challenges facing the sector and our regulatory and supervisory approach in this regard. I particularly want to acknowledge the important role which credit unions play within communities and as a provider of choice and competition within the financial sector. Our regulatory and supervisory actions are taken to ensure that the sector can survive and thrive into the future, and has the capability to adapt to the changing environment and meet the needs of members in a modern and progressive way.

In my statement, I will focus on three main areas:

1: The current position of & main challenges for the credit union sector;

2: The standards the Central Bank requires of credit unions so that members' funds are protected and the sector is stable; and,

3: Requirements for growth and development of the sector to remain sustainable into the future.

1. Profile of the Sector

For a number of years, credit unions have been dealing with the effects of financial crisis, economic downturn and a period of fundamental change and structural challenges. Recent legislation and regulation have been designed to better position the sector for the future. The prudential decisions that we in the Registry have taken are designed to ensure that credit unions are more robust and viable and therefore better able to serve their members needs and deal with future challenges. The decisions included restrictions on inappropriate lending; stronger liquidity and reserves requirements, and emphasis on improved provisioning levels. In addition, we used extensive onsite engagement with the sector to bring a focus to strategic planning, governance, risk management and controls, and we required remediation actions to be prioritised to best safeguard members funds.

Today there are 339 active credit unions with a total asset base of €15 billion. When we speak of the sector it is important to remember that we are dealing with a large number of independent financial entities, of varying sizes and levels of resilience to operating and economic challenges. The majority of credit unions have assets of below €25 million (170 credit unions representing c. 14% of sectoral assets have an average individual asset size of just over €12million) and these credit unions often face particular challenges, given their limited capacity to make the necessary resource and financial investments to develop new products and delivery channels, which would best position them to attract and retain younger active members. 37 credit unions have assets of €100million or more and account for just over 40% of total sector assets and for these entities our supervisory expectations are highest.

The biggest challenge the credit union sector faces is the fall in core loan income. Loans to members have decreased to €4billion from €7billion in 2008, while total interest income fell by over 40%. The key indicator of sector growth potential – the loan-to-asset ratio - has fallen to 28% from its 2008 level of 52%, and nearly 200 credit unions are below the average. The reasons for this include the impact of both the crisis – especially the fall in household and small business borrowing – and underlying structural factors. These structural issues include the ageing membership base of the sector, and the difficulties which many credit unions face in changing their business offerings to attract younger borrowers by offering the services they want, via the channels they expect and which often require technology investment that smaller credit unions, in particular, struggle to deliver.

Investment income helped to offset some of the declining loan income, but this is now also under pressure in the current low yield environment. At the same time, the cost-to-income ratio of credit unions is increasing. Together, these factors present a challenge to the longer term viability of a number of credit unions. While many are reasonably well provisioned and have adequate reserves - due largely to the way that they responded to regulatory initiatives in these areas in prior years - current loan arrears remain very significant at 13.5% on average and a number of credit unions have arrears exceeding 30 per cent of their loan books, reflective of poor historic practices.

While the economic situation has now improved and credit unions are showing some signs of benefitting, the sector is still grappling with the combined effects of the crisis and its structural challenges. Given the wider context of on-going indebtedness and deleveraging by households and businesses, the potential of the sector to benefit from the wider economic upswing is somewhat limited.

I want to acknowledge the scale of the challenges which credit unions across Ireland have dealt with over the past half-decade, and the efforts undertaken by management, Boards, members and volunteers, to help deal with the impact of the crisis and its aftermath on their credit unions and their members. Many credit unions took appropriately conservative responses – such as increased provisioning, cutting dividends and significant efforts to adopt new regulations – to steer through the difficult period. Further strong efforts and indeed strong leadership at the sectoral level are needed now to address the financial weaknesses and especially the structural challenges, to position credit unions for growth and development ahead.

2. Standards required for sector stability and the protection of members savings

The Commission on Credit Unions, in 2012, recommended the introduction of a strengthened regulatory framework for credit unions. The Credit Union and Co-Operation with Overseas Regulators Act 2012 ("the 2012 Act") significantly reformed the governance and risk management requirements necessary for the evolution of the sector. The revised framework was developed proportional to the nature, scale and complexity of the Irish credit union sector.

Our onsite engagement with credit unions has focused on implementing these requirements, including ensuring forward-looking strategies for credit unions to survive and thrive, and identifying key risks for remediation. In May 2014 we summarised our findings from onsite engagements in our published report "Credit Union Risk Assessments – Supervisory Commentary". This set out our concerns at the weaknesses in governance and risk management standards and practices which we observed in those engagements, and also the fundamental business model weakness of many credit unions. This document also set out our

minimum supervisory expectations for credit unions, which reflect public expectations and our statutory requirement to safeguard members' funds.

This year, the external review of the Central Bank's performance of its regulatory functions with respect to credit unions – required by law - was carried out by the International Credit Union Regulators' Network (ICURN). This Review determined that the Central Bank effectively performs its regulation and supervision functions, and that our supervisory practices are commensurate with the complexity, size and risk profile of the sector and the individual credit unions supervised. It also made recommendations for enhancement in our approach and we have adapted our inspections and engagement model accordingly.

We now profile credit unions according to their viability risk and we target supervision in a proportionate way. We have minimum standards expected of all credit unions and higher standards expected of larger credit unions with more complex business models and risk profiles. On viability risk, we are concerned at the trend decline in net return on assets, which is required to fund dividends and prudently provide for balance sheet growth.

We continue to focus our efforts on strengthening the regulatory framework for credit unions in a proportionate way. There have been concerns raised about some of our proposed new regulations, especially the decision to cap the amount of savings an individual member can hold in their credit union at €100,000. We have considered all of the arguments put forward, but we remain convinced that putting this cap in place is the right decision for the sector at this time. This cap ensures that members' savings in their credit union will be fully protected in the event of a resolution, which will also help to protect the financial stability of the sector, given the wider potential negative impact of any credit union member losing any of their savings. It is our responsibility, as Regulator, to take measures at the sector-wide

level to minimise risks or vulnerabilities, especially at times when the sector is going through transition and facing structural challenges.

One of the arguments put forward against the cap is that it will limit the ability of credit unions to develop their business models. This is hard to accept, given that the figures show, at this time, that savings of over €100,000 represent a very small proportion (1%) of total savings. We also note that, at the sector-wide level, credit unions are holding extensive deposits relative to their lending needs, and many have self-imposed deposit limits well below our proposed cap.

However, we have indicated that where there is clear business case and sufficient safeguards in place to protect members' funds, we will consider permitting credit unions to retain existing savings over €100,000 and in certain cases to take in new savings of over €100,000. However, this can only be allowed under very restrictive conditions to ensure the safety of members savings.

3. Viability and Sustainability into the future.

Earlier in my remarks, I pointed out the difficulties facing the sector. I also want to set out our vision, which is for a thriving credit union sector that provides choice in the financial system, while carrying out its important role at community level and meeting our regulatory requirements. To get from where we are now to where the sector needs to be will be difficult but we see four main requirements for sector recovery and growth : further restructuring, drive for new younger active borrowers, marked increase in core lending, and business model development in a multi-step, risk-managed way.

Restructuring is – as acknowledged by the Commission on Credit Unions - necessary to address the viability and operational challenges that continue to face many credit

unions. There has been solid progress this year – we now have 339 active credit unions, down from 376 a year ago – although more needs to be done to provide the efficiencies and capacity to tackle the structural challenges facing the sector. Most mergers provide an important starting point to address financial and operational weakness and to update the product and services offerings.

We have also worked closely, with credit unions and their representative bodies, to resolve a number of unviable credit unions that could not demonstrate their ability to adequately safeguard their members' funds. We have done so with minimal disruption to services, no loss of funds to any member and via solutions within the credit union sector itself.

The drive to attract and retain active borrowers is the cornerstone of the future of the credit union sector. I would urge the sector to consider how to leverage its community advantages and its excellent and trusted brand to become more relevant to a new generation of members, while pricing appropriately for its risks and its services.

There has been some criticism that the Central Bank is holding back the development of credit unions into new business areas, or that regulation is too restrictive. I would like to respond to these assertions. To date at the Registry, we have not seen enough from credit unions by way of well-structured, viable and sustainable plans for development which also deal with the current operational and financial challenges that have to be dealt with to move forward successfully. Many of the proposals we see are not aligned to current business strategy and capabilities, or they fail to demonstrate how the proposed new service or product will contribute to credit union profitability and sustainability as well as affecting costs and risks.

Our focus is to ensure that proposed developments are carefully assessed (including the additional technology, expertise and governance required), are properly costed, and consider risk and potential return. The safe and prudent approach is a multi-step development of the business model.

To bring additional clarity to the challenges around business model development, we recently initiated a stakeholder dialogue process, where we engage with credit union stakeholders on their priorities for business development and our expectations to ensure that regulatory standards are met and members' funds appropriately protected. Where credit unions set out a clear path on how they wish to develop, we consider any amendments to the regulations that may be appropriate. A recent example is the change to our forthcoming Regulations to include explicit reference to "projects of a public nature" (which would include but not be limited to social housing projects) as a permitted class of investments – in line with the provisions in legislation.

At the Registry, we are fully committed to using all of the powers within our regulatory remit to help credit unions to help themselves and thereby to help their members. In this regard, we recently undertook a review of lending restrictions across the sector. These restrictions had been imposed to limit risky lending and excessive risk taking, during the crisis, while necessary remediation work was undertaken. Our subsequent engagements had shown that the underlying weaknesses in lending practices remained unaddressed in many cases so the restrictions remained in force. The restrictions had been calibrated to allow credit unions to lend responsibly in amounts between €10,000 and €30,000 (compared to average loan size of €8,000) and our research suggested the restrictions did not constrain responsible lending. However, we were concerned at the lack of impetus in the sector to improve standards to

have the restrictions removed, so we initiated a review earlier this year. We have since been able to lift restrictions in a significant number of cases where credit unions prioritised improvements in their credit risk systems and controls and met our requirements.

It has been a challenging period for the credit union sector, and I would like to acknowledge the constructive and positive engagement of individual credit unions, their representative bodies and other key stakeholders, as we work to improve the resilience and future prospects of the sector. As I said, the sector has benefitted from appropriately conservative actions in recent years by most credit unions through increased provisioning, cutting dividends, adopting new regulatory requirements and entering into mergers which provide better long term prospects for many members. While significant vulnerabilities remain, the most important challenge is to drive sustainable development of the sector while retaining its important voluntary ethos and community spirit into the future.

Thank you for your attention.