The Regulatory Reserve Ratio for Credit Unions: Time for Change?

The following is a synopsis of the feedback received from discussions in the Breakout Sessions.

Question One: Why might now be a good time to propose change in the regulatory capital requirements for Irish Credit Unions?

1) Unprecedented growth in savings due to the pandemic and the closure of main banks is causing a dilution in the reserve position.

2) Credit Unions being forced to return savings to members goes against the ethos of the credit union in encouraging thrift among its members.

3) The same level of risk cannot be proportioned to all asset categories, not all risks are equal. For example, it doesn't make sense to hold 10% against funds in the MMR / sovereign bonds.

4) Credit Unions haven't seen a significant bounce-back as the effects of the pandemic have eased.

5) Investment income is low with no evidence of an upturn in returns over the next 4-5 years. The time is now right for the Central Bank to ease capital pressures on Credit Unions.

6) The Model as we know it is broken, last year was extremely difficult due to increased savings.

7) Members are most likely to be running down savings rather than borrowing post pandemic.

8) Banks leaving the Irish Market have mentioned capital requirements. All financial services should be included in a review of regulatory capital and reductions sought.

9) Change takes time! It is clear that strategic plans and projections are facing significant challenge in 2023 to 2024. Discussions on regulatory capital needs to start now.

10) It helps that capital requirements are also currently on the agenda for banks in Ireland.

11) This is now a systemic issue for the Credit Union sector, indeed it is an issue for all Credit Unions irrespective of size, current capital ratio or loan to assets ratio.

12) Credit Unions are coming under increasing pressure from the Central Bank. The 10% capital requirement is seemingly not negotiable!

Question Two: What are the weaknesses associated with the current capital requirements and do you foresee potential risks with the proposed Asset Link Capital ratios? Are there any other points that you would like to raise regarding the Capital regime in place for Irish Credit Unions?

1) Main risks are in the loan book, but even here default rates are still well below the capital required percentage of 10%.

2) Central Bank clearly hasn't fully considered where shares are being held. There is merit in including a 0% capital requirement in holdings in certain areas such as MMR. A risk weighted approach to the regulatory capital requirement position makes much more sense.

3) Credit Unions have professional CEOs and Management Teams in place – Fitness and Probity Regime and Pre-Approval Controlled functions (PCFs) provide assurances around this. Credit Unions have much greater capabilities now (than in the past) to manage risks to capital.

4) Credit Unions need to grow and change their business model and need the regulatory structure around capital to support this.

5) The 12.5% capital requirement for additional longer term lending needs to be addressed. Residential mortgage arrears default rates are approximately 6%! There is merit in challenging the basis for both 10% and 12.5% regulatory capital levels.

6) The present Central Bank risk based model requirements reflect a one size fits all. This is too blunt. The Central Bank needs to consider bespoke requirements for each Credit Union. The proposed Asset Linked Ratio model would reflect this with different rates for each Credit Union.

7) Risk Weighting should be applied to capital/reserves!!

8) The risk model has changed (for the better) since 2008. This should be recognised and by the Central Bank and change implemented.

9) Asset link Capital ratios seem to be more suitable but this needs to be teased out. The devil is in the detail. Make sure it is the right choice going forward.

10) Danger of Central Bank rejecting low capital level out of hand citing next pandemic.

11) Caps and transfers of engagements appear to be only solutions available to Credit Unions and aren't the answer to the capital issue.

12) We are expected to hold a buffer sometimes to 13% of capital, not just 10%. With increased level of savings, we should not have to keep such high levels of capital.

Question Three: How can credit unions use the excess Capital to deliver real world community impact for more members given the backdrop of the pandemic, the elevated savings levels and reducing competition in the financial service landscape?

1) Capital reduction gives breathing room to develop products and services. Credit Unions need to facilitate speed and ease of access for members and move with electronic banking developments.

2) There is a need for collaboration, particularly for smaller Credit Unions. There is a need to develop partnerships.

3) Opportunity exists around approved housing bodies but there needs to be clear governance structures / capital guaranteed.

4) Fill gap left by banks leaving the market, diversify with current accounts, insurance and other services.

5) Credit Unions are under lent. Central Bank solution is to grow the business. However, there are too many constraints / restrictions. For example, mortgage provision on business properties and holiday properties

6) Need to actively seek customers from KBC (leaving the market), Bank of Ireland (closing branches).

7) Develop solutions as an alternative to Provident – if Credit Unions don't act, Payday lenders will fill the gap. Such action fits with the Credit Union ethos.

8) Larger Credit Unions could invest in initiatives that all Credit Unions could use.

9) Invest in technology. Introduce new products to benefit members.

10) Broaden membership base – attract old/dormant members back.

11) Donations to community projects. Credit Unions should be able to use the surplus to fund community projects and engage in business development.

12) Need to focus on members when talking to Central Bank about the need for change – so many Credit Union members use the Credit Union for all their financial needs and caps are driving members to other financial institutions, calls into question viability of Credit Unions for members.

13) In terms of development Credit Unions have made huge strides recently through digitalisation and collaboration, however further development requires additional investment and Credit Unions are nervous about this due to focus on capital and limited ability to control the Balance sheet.

14) Look at the Social impact report last year and how our overall interaction could be improved.

Question Four: The CEO forum have planned the next steps to bring this Regulatory Capital paper forward, which include liaising with the Representative bodies, and meeting with the Department of Finance and the Central Bank. What might you as a CEO and your Credit Union do to progress this agenda?

1) Each Credit Union should discuss with their RCU Supervisor.

2) Discussion with Department of Finance is key – influence needs to come to the Central Bank from the Department.

3) CEOs can bring the capital presentation to their Board to build momentum. It is very important to have a well-informed Board who can support this agenda and engage in lobbying.

4) Each Credit Union should send a 'Business Case' for change in regulatory capital to the Central Bank.

5) Greater collaboration needed for more power, cooperative movement should not be in competition with each other. Meaningful collaboration of all Credit Union Representative Bodies is needed with all 'singing from the same hymn sheet'

6) Use Chapter groupings to promote the change agenda.

7) Credit Unions should individually express their support for the capital paper.

8) Representative organisations be asked to support the paper – each Credit Union should write to their representative body.

9) Present paper to CUAC for presentation to the Minister of Finance.

10) Lobby politicians at local level, need tangible standardised document for all Credit Unions to quote from – CEO Forum could provide this to maintain the pressure for change.

11) Keep the message on Boards' agendas (for discussion) and at management level

12) All should be clear on the message, Board, Chapter - lobby TD's….be on the news and papers getting the message out to all including our members.

13) Bring the capital calculations template down to the individual Credit Union so that Boards are clear on how this affects their Credit Union and can then more easily advocate the case for change.

14) Unified approach from all stakeholders (CUMA/CUDA/ILCU/Metamo ....) is required.

15) Need to illustrate stark reality of impact of inappropriate 10% ratio on a Credit Union's capacity to act as it was intended.

16) We need the ILCU, CUDA, CUMA to meet with the CEO Forum to discuss the capital paper and to get their support. We need there to be no fragmentation. This paper/report should be used as the basis for change.