

**Report of the
Commission on Credit Unions**

March 2012

Report of the Commission on Credit Unions

Mr. Michael Noonan, TD,
Minister for Finance

Dear Minister,

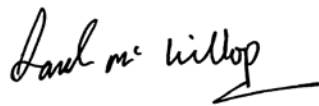
Enclosed is the Report of the Commission on Credit Unions which according to the Terms of Reference for the Commission was to be presented to you by end-March 2012.

When I presented the Interim Report of the Commission to you last September, I said I believed that the recommendations contained in the Report would provide a strong foundation for addressing the difficult problems in the sector. Those recommendations are integrated into this the final Report which covers the full terms of reference. The Reports discusses what sets credit unions apart from other financial institutions, it provides an updated financial position of the sector, looks at international best practice and presents the Commission's view on where the Irish credit union movement should be headed. It then goes on to make proposals for stabilising and restructuring the sector and for strengthening the legislative and regulatory frameworks, including an improved governance regime.

I was pleased to have had the full commitment and meaningful engagement from the members of the Commission throughout the project. The support and commitment from the Department of Finance Secretariat was critical to the work of the Commission and will continue to be critical in ensuring the recommendations are carried though.

The Commission's recommendations are far reaching and I know that this Report is eagerly anticipated across the credit union movement. I am available to brief you on its contents whenever your diary permits. It would be the intention of the Commission to launch the report before the end of April after you and your Government colleagues will have had an opportunity to study its contents.

Yours sincerely,



Donal McKillop
Chairman of the Commission on Credit Unions

30th March 2012

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Executive Summary

1. Background

- 1.1 This is the final report of the Commission on Credit Unions and was presented to the Minister for Finance, Mr. Michael Noonan, T.D., on 31 March 2012. The purpose of this report is to inform the preparation of credit union legislation, to be published by end-June 2012, and to make recommendations regarding the strengthening of the regulatory framework of credit unions, including more effective governance and regulatory requirements.
- 1.2 The Government established the Commission on Credit Unions on 31 May 2011 to review the future of the credit union movement and make recommendations in relation to the most effective regulatory structure for credit unions, taking into account their not-for-profit mandate, their volunteer ethos and community focus, while paying due regard to the need to fully protect members' savings and financial stability.

2. The current financial position of the Credit Union Sector in Ireland

- 2.1 The adverse economic conditions have resulted in a decline in credit union performance and have made it difficult for some credit unions to replenish reserves through retained earnings. As at 31 December 2011, of 403 credit unions that submitted prudential returns, 51 credit unions had total realised reserves less than 10% of assets and 25 credit unions could be considered seriously undercapitalised (less than 7.5%)¹. At that time, 352 credit unions (87%) held at least 10% of assets as total realised reserves².
- 2.2 Despite the financial crisis and the challenges that it has posed, average liquidity has remained high and in December 2011 stood at 47.38%. The loan-to-asset ratio in the sector was 40.76% in 2011.
- 2.3 The financial profile reveals a commonality of the issues faced by credit unions of all sizes and common bond types. The declining fortunes of the Irish economy have not only put an additional brake on credit union development but arguably have contributed to regression in some credit unions. The Central Bank of Ireland's projections envisage a further deterioration in credit union solvency. While the financial challenges now faced by credit unions are evident, they are not insurmountable but do reinforce a clear need to reform how credit unions are

¹ Since that date non-State stabilisation support has been agreed for some of these credit unions to address the position.

² The Regulatory Reserve Ratio requires credit unions to hold a minimum of 10% assets in Total Regulatory Reserves.

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structured, governed and regulated. A strengthened and re-vitalised sector can be in a position to play an increasing role in the retail financial landscape.

3. Summary of the main recommendations

Implementation

- 3.1 The Commission recommends that a group be established to oversee implementation of the recommendations of the Report.

Restructuring

- 3.2 A core recommendation is that the credit union sector should be restructured. This should be achieved on a voluntary, incentivised and time-bound basis. Credit unions approved for restructuring should be provided with funding, where required and subject to conditions, to ensure they have adequate capital and to upgrade systems.
- 3.3 Restructuring will not apply to all credit unions. Some credit unions will continue to operate successfully on a stand-alone basis should they so choose, provided that they have a viable business model capable of meeting regulatory requirements.
- 3.4 The amount of funding required for restructuring will not be known until the position of the participating credit unions is fully assessed over the coming months. It is envisaged that a significant funding requirement will be needed.
- 3.5 The Commission proposes that restructuring should be funded as follows:
- The first call should be on any available excess capital within the participating credit unions
 - The affordability of sector-wide contributions should be assessed, having regard to the cost of existing and impending levies on the credit union sector for regulation, resolution, stabilisation, etc.
 - Exchequer funding should be provided on a recoupable basis
- 3.6 The Commission recommends that restructuring should be overseen by a board established on a short-term basis with a view to completing the process within four years. The Board will also have a limited operational role in facilitating and coordinating restructuring proposals.

Resolution

- 3.7 The Commission recommends that the resolution powers provided to the Central Bank under the Central Bank and Credit Institutions (Resolution) Act 2011 should be considered for those credit unions that meet the intervention conditions or grounds set out in that Act.

Regulation

- 3.8 The Commission recommends the introduction of a strengthened regulatory framework which credit unions will have to adapt to as it is phased in over time.

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However, credit unions should not be regulated on a one-size-fits-all basis; rather a tiered regulatory approach should be adopted.

- 3.9 The Commission considered that some of the new regulatory requirements may not be required for those smaller credit unions that want to operate a simpler business model. Therefore, it is recommended that those credit unions be permitted to opt for a more limited business model under a simpler regulatory regime.
- 3.10 Some larger credit unions that are capable of operating on a more sophisticated basis should be allowed to offer a wider range of products and services and engage in a broader range of lending and investment activities. This should be permitted under a more sophisticated regulatory regime for these credit unions.
- 3.11 The Report recommends revisions to the requirements around loan rescheduling, usually referred to as “Section 35 Requirements”, to make them clearer and more effective and to respond to feedback on their implementation to date.

Consultation and Impacts

- 3.12 The Commission recommends that a consultation protocol should be in place between the Central Bank and credit unions.
- 3.13 When setting out new regulations, the Commission recommends that the Central Bank undertake a Regulatory Impact Analysis (RIA) in line with existing requirements and having regard to international best practice.

Governance

- 3.14 As the sector’s key decision makers, boards of directors shape the strategic direction and performance of credit unions around the country. The Commission recommends a Governance Standard for credit unions to ensure that those entrusted with safeguarding members’ money are skilled and experienced people of integrity, with the necessary underpinning systems and controls to run credit unions in a verifiably prudent way. Many of the governance changes will be phased in over time and will be calibrated according to the size and complexity of the credit unions to which they apply.
- 3.15 The Commission makes recommendations in relation to governance including:
- The composition and role of the board
 - The role and responsibilities of the manager
 - Fitness and probity
- 3.16 The Interim Report recommended that operational responsibilities currently assigned to the Supervisory Committee should be transferred to the internal audit function. In recognition of the change to the Supervisory Committee’s responsibilities and the key oversight role played by the Supervisory Committee, the Commission further recommends that the Supervisory Committee is renamed as the Board Oversight Committee and the primary function of the Board Oversight Committee should be to assess whether the board has operated as required by the governance standard.

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Legislation

- 3.17 The report sets out the draft outline of the Credit Union Bill to be published in June 2012 under the EU-IMF Programme. That Bill will provide for many of the regulatory and governance changes recommended and set out in this report.
- 3.18 The Bill will also provide the statutory basis for the stabilisation scheme recommended in the Commission's Interim Report. To avoid any conflicts or overlaps during the restructuring process, the Commission recommends that stabilisation strictly be used to address short-term problems at credit unions that are viable but undercapitalised. Stabilisation should not be used to address underlying structural problems with credit unions that ought to be addressed more appropriately through restructuring or resolution.
- 3.19 The Commission also recommends a number of amendments to the Credit Union Act 1997, including an appeals mechanism for regulatory directions.

Credit Union Model

- 3.20 The Commission is not recommending fundamental change to the common bond (the membership charters that apply to credit unions and defines their membership base by reference to geographical location or occupation).
- 3.21 The Commission recommends that where credit unions seek to broaden the range of services they offer, this should be done within the tiered approach to regulation.
- 3.22 International experience shows that there is scope for improved collaboration and efficiency through shared services arrangements and the Commission recommends that these should be facilitated in legislation for Irish credit unions.
- 3.23 The Commission took the view that ICT needs are best defined at credit union or movement level and should be driven by business strategy and the changing needs of credit unions' current and potential members. The Commission did note that there is scope for better and closer co-operation and co-ordination among credit unions towards shared services and standardisation of processes, which could do a lot to reduce costs and improve efficiency.

Volunteers

- 3.24 The Report discusses the role of volunteers, highlighting the varied and important roles that volunteers can fulfil and outlining how credit unions and the movement at large might be more effective in attracting and developing volunteers.

Financial Inclusion and Social Lending

- 3.25 Credit unions have an important role to play in financial inclusion and social lending. The Report sets out a number of ways for credit unions to do more in this space and at the same time ensuring that this does not create unhealthy risk exposures in the sector.

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- 3.26 The Commission recommends that credit unions should continue to co-operate with service providers such as St. Vincent de Paul and MABS. The Commission also identifies that the role of credit unions in providing the Basic Payment Account could be enhanced through affordable access arrangements to bank service delivery infrastructure.
- 3.27 The Commission recommends that credit unions could take a more prominent role in developing and maintaining social inclusion lending schemes. These schemes should be backed up with support mechanisms to facilitate credit unions becoming more actively involved in social lending.

Interim Report

- 3.28 For ease of use, the Final Report incorporates the Commission September 2011 Interim Report, which made a number of important recommendations that are summarised below:
- The establishment of a credit union stabilisation mechanism to support viable credit unions in a time-bound process.
 - A prudential rulebook for credit unions setting out a comprehensive framework of regulatory requirements.
 - Changes to credit union requirements on governance, competency, risk management, internal audit, lending, compliance, liquidity and other matters.
 - Commencement of Part III of the Central Bank Reform Act 2010 for credit unions. This will provide the Central Bank of Ireland with the powers to set out the Regulations and Code of Fitness and Probity for the credit union sector.
 - Credit unions to remain subject to the general deposit guarantee and their financial contributions under the scheme to commence.
 - Central Bank of Ireland powers to inspect, investigate and gather information from credit unions.
 - Extension of the Central Bank of Ireland's administrative sanction regime to credit unions.
 - Application of the provisions of the Central Bank (Supervision and Enforcement) Bill 2011 to credit unions.

This Report does not impact on the independence of the Central Bank of Ireland in the performance of its statutory functions and this Report is without prejudice to the performance by the Central Bank of Ireland of its statutory functions.

Abbreviations

| | |
|---------------|---|
| AGM | Annual General Meeting |
| BPA | Basic Payment Account |
| CF | Controlled Function |
| CUAC | Credit Union Advisory Committee |
| CUCC | Credit Union Central of Canada |
| CUDA | Credit Union Development Association |
| CUMA | Credit Union Managers Association |
| CUNA | Credit Union National Association |
| CUSCAL | Credit Union Services Corporation Australia Ltd |
| CUSO | Credit Union Services Organisation |
| EACB | European Association for Co-operative Banks |
| FSA | Financial Services Authority |
| FSCS | Financial Services Compensation Scheme |
| IBEC | Irish Business and Employers Confederation |
| ICA | International Cooperative Alliance |
| ICT | Information and Communications Technology |
| IFSRA | Irish Financial Services Regulatory Authority |
| ILCU | Irish League of Credit Unions |
| MABS | Money Advice and Budgeting Service |
| NCUA | National Credit Union Administration |
| PCA | Prompt Corrective Action |
| PCAR | Prudential Capital Adequacy Review |
| PCF | Pre-approval Controlled Function |
| PRISM | Probability Risk and Impact System |
| RIA | Regulatory Impact Analysis |
| UCC | University College Cork |
| UFCU | Ulster Federation of Credit Unions |
| WOCCU | World Council of Credit Unions |

Chapter 1 - Introduction

1.1 Introduction

1.1.1 The credit union movement has had a presence in Ireland for over 50 years and the number of credit unions has grown to over four hundred, with almost three million credit union members. However, the credit union sector has not been immune to the recession, in particular, the effects of rising unemployment, declining property prices and falling domestic demand. While the financial challenges are evident, they are not insurmountable. However, the challenges that the Irish credit union sector faces are not wholly related to economic factors. Other contributory factors include the business decisions of some credit unions and the deficiencies in the statutory regulatory framework. It is clear to the Commission that there is a need to reform how credit unions are governed and how they are regulated. Furthermore, the Commission is of the opinion that there needs to be a degree of restructuring within the sector in order to improve efficiency and maintain the strength and stability of the sector into the future. The Commission has focused on achieving this. It is the Commission's strongly held view that a restructured credit union sector can be in a position to play an important part in Ireland's financial landscape.

1.1.2 The work of the Commission has relied on the main stakeholder bodies and a number of independent people coming together in a frank and open forum to set out how they believe the credit union sector should develop. This report is the synthesis of these discussions, as such, the majority of recommendations were achieved by consensus.

1.1.3 An interim report was provided to the Minister for Finance, Mr. Michael Noonan, T.D., on 30 September 2011, as required under its Terms of Reference.

1.1.4 This final report was provided to the Minister for Finance on the 31st March 2012. The purpose of this report is to inform the preparation of credit union legislation, to be published by end-June 2012, and to make initial recommendations regarding the restructuring of the credit union sector and the strengthening of the regulatory framework of credit unions including more effective governance and regulatory requirements.

1.2 Establishment of the Commission on Credit Unions

1.2.1 The Government established the Commission on Credit Unions on 31 May 2011 to review the future of the credit union movement and make recommendations in relation to the most effective regulatory structure for credit unions, taking into account their not-for-profit mandate, their volunteer ethos and community focus, while paying due regard to the need to fully protect depositors savings and financial stability. The Commission's Terms of Reference are set out in Appendix 1.

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1.2.2 The Minister for Finance appointed **Professor Donal McKillop**, Professor of Financial Services, School of Management, Queens University, Belfast as member and Chair of the Commission on Credit Unions (referred to in this report as the ‘Commission’). The Minister also appointed as members of the Commission:

- **Mr. Kieron Brennan**, Chief Executive Officer, Irish League of Credit Unions
- **Ms. Fiona Cullen**, Head of Legal Department, Irish League of Credit Unions
- **Mr. Billy Doyle**, Management Committee, Credit Union Development Association (**Mr. Kevin Johnson**, CEO, CUDA, deputised on occasion)
- **Ms. Eileen Fitzgerald**, Senior Manager in the Citizens Information Board, with responsibility for MABS
- **Mr. Eamonn Kearns**, Financial Services Division, Department of Finance, replaced by **Mr. Aidan Carrigan**, Financial Services Division, Department of Finance
- **Dr. Tom McCarthy**, Chief Executive Officer, Irish Management Institute
- **Mr. Tim Molan**, National Secretary, Credit Union Managers Association
- **Mr. Robert Moynihan**, Independent Compliance and Risk Management Consultant
- **Mr. James O’Brien**, Registrar of Credit Unions (**Ms. Elaine Byrne**, Deputy Registrar, deputised on occasion)
- **Mr. Daniel J. O’Gorman**, Solicitor
- **Mr. Joe O’Toole**, Former Senator, and
- **Professor John Wilson**, Professor of Banking and Finance, St. Andrews University, Scotland.

1.2.3 The Commission was supported in its work by a Secretariat provided by the Department of Finance:

- Ms. Bríd Kemple, Secretary to the Commission
- Mr. Antoine MacDonncha, Legal Advisor to the Commission
- Mr. Rónán Hession
- Mr. Michael Quinlan
- Mr. Fiachra Kennedy

1.2.4 Substantial further support was provided by Central Bank staff:

- Ms. Aoife Langford
- Ms. Anna Marie Finnegan
- Ms. Deirdre Dalton

1.3 Methodology of the Commission on Credit Unions

1.3.1 The Commission met for the first time on 20 June 2011 and between June 2011 and 30 March 2012, the Commission met on 29 occasions.

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Phase 1 – June 2011 – September 2011

- 1.3.2 During the first phase of its work, the Commission focussed on the following areas:
- Governance
 - Regulation
 - Risk Management
 - Stabilisation mechanism
 - Resolution mechanism
 - Liquidity mechanism
- 1.3.3 On 24 June 2011, the Secretariat arranged for members of the Commission to be briefed by representatives from Grant Thornton and the Central Bank of Ireland on key issues pertaining to the sector:
- Strategic Review of the Credit Union Sector – Results of Phase 1,
 - Current Trends in the Credit Union Sector,
 - 2010 / 2011 Loan Book Reviews, and
 - Prudential Capital Adequacy Review (PCAR) for Credit Unions 2011.
- 1.3.4 Representatives from the *National Supervisors' Forum* presented a paper making recommendations on the role and importance of Supervisory Committees.
- 1.3.5 The Commission also received presentations on:
- The Central Bank (Supervision and Enforcement) Bill 2011, and on
 - The Central Bank and Credit Institutions (Resolution) (No.2) Bill 2011.
- 1.3.6 In order to fully inform itself of the issues involved, the Commission decided to hold a public consultation. The consultation process sought submissions from members of the public and interested parties that would facilitate the good functioning of the Irish credit union movement into the future. In particular, submissions were invited on the role of credit unions, their current operating model, shared services, financial inclusion, governance standards, regulatory requirements and changes to credit union legislation - set out in Appendix 2. These submissions were used to inform the Commission's final report. An overview report of the main points raised by these submissions is presented in Chapter 5.
- 1.3.7 The Interim Report, which was published in October 2011, contained recommendations in relation to:
- Deposit protection, resolution, and stabilisation, including the establishment of a steady state stabilisation mechanism,
 - Governance, including recommendations on risk management, internal audit and fitness and probity, and
 - Regulation of credit unions, including the introduction of a prudential rule book and administrative sanctions.

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Phase 2 – October 2011 - March 2012

1.3.8 In Phase 2 the Commission's main focus related to the following areas:

- Alternative structural models and international perspectives
- A vision for the credit union sector
- Future roles for credit unions including products and services
- Information technology
- Centralised and shared services
- Restructuring of the sector
- Regulation and legislation
- Governance

1.3.9 In carrying out its work, members of the Commission provided papers on each of these issues. The Secretariat then sought to assimilate the papers into single documents for the Commission's considerations. The Chapters in this report are the outcome of this work. The Commission also based its work on international best practice and the outcomes of academic research and these are noted in the report through the use of endnotes. (A comprehensive bibliography is also provided.) Further more detailed analysis is provided as Appendices to the Report and Annexes to the individual Chapters.

1.3.10 In order to further inform its work, the Commission also undertook a survey of credit unions in Ireland which sought the opinions of credit union boards on a wide range of issues including shared services, mergers, information technology, future vision, product and service offerings and internal and external constraints on credit union development.

1.3.11 The Commission also received a number of further presentations from:

- The Department of Jobs, Enterprise and Innovation on Friendly Societies
- Bayberry Consulting, the Credit Unions Technology Suppliers Forum and the ILCU on information technology
- The Credit Union Services Co-operative Limited (trading as the Credit Union Alliance) on shared services
- The Department of Finance and the Department of Justice and Equality on the draft scheme of the Personal Insolvency Bill

1.4 Structure of the Report

1.4.1 The report is set out as follows:

Chapter 2 – Defining Features of Credit Unions

1.4.2 This chapter sets out the key features of credit unions that apply across all credit union movements and then compares movements across countries. Credit unions in some countries are more advanced than they are in other countries and the developmental stages can be classified as nascent, transition and mature. The Chapter then gives a brief description of the development of the Irish credit union

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movement from its inception in the late 1950s. This Chapter concludes with a discussion of the role of the credit union sector in the context of the overall financial services sector in Ireland.

Chapter 3 – Current Financial Position of the Credit Union Sector in Ireland

- 1.4.3 This Chapter examines the financial position of credit unions in Ireland. Rather than taking the current position, it compares how the sector has fared both prior to the financial crisis and throughout the present economic downturn. A forward assessment is also included with consideration of the Central Bank's projections. The analysis in this Chapter identifies the financial strengths and weaknesses of the sector and sets the framework for the Commission's recommendations.

Chapter 4 – Credit Union Survey Analysis

- 1.4.4 This Chapter presents and analyses the findings arising from the survey of credit unions undertaken by the Commission. The survey period commenced at the beginning of December 2011 and concluded at the end of January 2012. Credit unions were requested to have the survey undertaken by a person authorised to do so by the Board. The survey returns were broken down in terms of asset size (greater than €60m; less than €60m but greater than €20m; less than €20m) and also in terms of community and occupational common bonds.

Chapter 5 – Synthesis Report on the Public Consultation

- 1.4.5 This Chapter provides a summary of major themes emerging from the submissions arising from the Public Consultation process undertaken by the Commission in July / August 2011. In some cases extracts from particular submissions have been included where they help illustrate points in greater detail. These submissions represent a sample of opinion from the consultation process and were chosen following a careful and objective reading of all the submissions. The broad themes discussed in this Chapter include the role of credit unions in a restructured sector, options for restructuring, shared services, financial inclusion and social lending and governance and help inform the discussion of the Commission later on in the report.

Chapter 6 – International Perspectives

- 1.4.6 This Chapter provides a broad overview of alternative financial co-operative models in various countries across Europe and North America. This includes analysis of the structure of federated models in Europe and the Desjardins models in Canada. It goes on to examine the less integrated 'atomised' credit union models in the United States including a discussion on Credit Union Services Organisations and corporate credit unions. The tiered approach adopted in the UK is also examined. The Chapter concludes with a consideration of the strengths and weaknesses of the respective models.

Chapter 7 – Future Models of Credit Unions

- 1.4.7 This Chapter sets out the Commission's vision for the future of the credit union sector in Ireland at a high level. The Chapter begins with an examination of the operating environment for the sector going forward and seeks to provide guidance to boards on

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how to determine a business model for their credit union. It sets out a new tiered approach to regulation based on the nature, scale and complexity of the credit union concerned. Within this context, there is a discussion on the vision for the trade bodies as well as the movement in general, particularly in relation to the common bond, the provision of additional services, shared services, information technology, and financial inclusion and social lending.

Chapter 8 - Deposit Protection, Resolution, Stabilisation and Liquidity

- 1.4.8 This Chapter sets out the Commission's recommendations with regard to designing a prudential management framework. The Commission makes recommendations regarding:
- (a) a deposit guarantee scheme to protect the savings of members up to a statutory minimum,
 - (b) a resolution mechanism to deal with credit unions that are 'not viable', and
 - (c) a steady state stabilisation support mechanism, in certain circumstances and with conditions, for credit unions that are facing difficulties but are otherwise considered 'viable'.

Chapter 9 – Sector Restructuring

- 1.4.9 This Chapter sets out the recommendations of the Commission on how the credit union sector may be restructured on a voluntary, incentivised and time-bound manner in order to allow the credit union sector perform to a greater level of efficiency. This Chapter examines the various proposals put forward by the Commission during its deliberations before setting out the agreed guiding aims of restructuring. These include the protection of credit union members' savings; the stability and viability of credit unions and the sector at large; and the preservation of the credit union identity and ethos. The Commission recommends the establishment of a board to engage with credit unions on the ground and facilitate the restructuring process. The Chapter concludes with how this process is to be funded and the timeline within which the restructuring is to be achieved.

Chapter 10 – Legislation and Regulation of Credit Unions

- 1.4.10 This Chapter sets out the recommendations of the Commission with regard to the regulation of credit unions to underpin the future evolution of the sector having regard to its particular ethos and nature and to ensure a stable credit union sector. It sets out the various aspects of the new regulatory regime including the introduction of a prudential rule book and regulation making powers for the Central Bank. It provides that consultation is to be a key part in regulation-making to ensure transparency and confidence in the process. The Chapter goes on to give an overview of credit union legislative proposals and proposed amendments to the Credit Union Act 1997.

Chapter 11 – Governance of Credit Unions

- 1.4.11 This Chapter aims to provide an overview of the new governance requirements which will be put in place in credit unions to reflect the modern regulatory framework for the sector. It sets out the aspects of the Governance Standard with which credit unions will be expected to comply and includes details on the roles

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and responsibilities of the board, the chair, the manager, the nomination committee and the internal audit function as well as aspects of risk management and systems and controls requirements. It also provides some details on the operation of the new fitness and probity regime and minimum competency requirements.

Chapter 12 – Conclusion

- 1.4.12 This Chapter provides a number of concluding comments. It acknowledges the increasing role for a strengthened and revitalised credit union sector into the future. This Chapter also includes a recommendation that there be an implementation group put in place to monitor and advise the Minister for Finance on progress.

Chapter 2 – Defining Features of Credit Unions

2.1 Introduction

- 2.1.1 This Chapter provides a description of the distinctive features of credit unions with emphasis placed on what sets credit unions apart from other financial organisations. Descriptive statistics are then provided on credit union movements worldwide with movements additionally classified in terms of a developmental typology (nascent, transition and mature). The historical development of Irish credit unions is described with summary information detailed on the legislative and supervisory framework under which credit unions operate. An analysis is also presented of the current position of credit unions in the provision of short term personal credit.

2.2 Distinctive Nature of Credit Unions

- 2.2.1 Credit unions are self-help co-operative financial organisations geared to attaining the economic and social goals of members and wider local communities. Each credit union is governed by its members. The membership elects (from within that membership) unpaid volunteer officers and directors who establish the policies under which the credit union operates. Voting within the credit union is on a one-member, one-vote basis. Credit unions cannot do business with the general public due to charter limitations based on serving a membership that is characterised by a common bond. The common bond is based on a pre-existing social connection (such as belonging to a particular community, industrial or geographic group). In the past, this helped in the absence of more formal systems of credit bureaux to assist with assessment of loan applications. However, the common bond also limits commercial diversification, and in many jurisdictions has become less important as the movement has matured.
- 2.2.2 In contrast to most other forms of financial services organisations, credit unions are not required to simultaneously satisfy shareholders' profit expectations and disparate customer needs. (See Box 1.) Furthermore, credit union managers are not awarded bonuses linked to equity shareholder value measures.¹ Instead, credit unions exist to attain the economic and social goals of the people who comprise their membership and surplus monies generated from business activities belong to the members. The distribution of any surplus may take a number of forms, including: allocation among members in proportion to their transactions; the development of common services to benefit all members; or the development of the business of the credit union. A key element is that any surplus should be distributed in a way that avoids one member gaining at another's expense.

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Box 1 Differences between Credit Unions and Banks

| Credit Unions | Banks |
|---|--|
| Not-for-profit, member-owned financial co-operatives funded primarily by voluntary member deposits. | For-profit institutions owned by shareholders. |
| Conduct business solely with their members, and their members are in turn the owners of the credit union, there is a coincidence of ownership and consumption. | Conflict between depositors and borrowers (the customers) and shareholders (the owners). |
| Members share a common bond, such as where they live or work. | Typically serve middle-to-high income clients. No restrictions on clientele. |
| Credit union members elect a volunteer board of directors from their membership. Members each have one vote in board elections, regardless of their amount of shares in the credit union. | Shareholders vote for a paid board of directors who may not be from the community or use the bank's services. Votes are weighted based on the amount of stock owned. |
| Surplus monies generated from business activities belong to the members, distribution method decided by members. | Shareholders receive a pro-rata share of profits. |
| Financial services provided are primarily basic savings and loan products with some insurance offerings. | A wide range of financial services are on offer. |
| Local offices, limited use of ATMs, internet and phone technology for the provision of services. | Branch network, sophisticated technology based provision and delivery of services. |
| Exist to attain the economic and social goals of members. | Exist to maximise profit and shareholder wealth. |

- 2.2.3 For all their distinctive features, credit unions are, first and foremost, financial institutions, which primarily accept deposits (or shares) and make loans. In this regard they are similar to commercial banks. However, with commercial banks there is an inherent source of conflict between depositors and borrowers (the customers) and shareholders (the owners). The former want competitively priced financial products, while the latter require as high a return as possible on their capital investment. The implicit assumption is that commercial banks place greater emphasis on maximising profits and shareholder value. In that credit unions conduct business solely with their members, and their members are in turn the owners of the credit union, there is a coincidence of ownership and consumption. However, credit unions still face a potential conflict between borrowing members (who want access to low-cost credit) and saving members (who want a high rate of return on funds invested)ⁱⁱ.

2.3 Credit Unions Worldwide

- 2.3.1 Credit unions have become a significant global phenomenon. Table 1 classifies credit

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union movements and presents some descriptive statistics on credit unions. In 2010, there were 52,945 credit unions operating in 100 countries. These credit unions had a membership of 188 million, which equates to a population penetration of 8% and had total assets under their control of approximately \$1,461 billion. The World Council of Credit Unions (WOCCU)³ (2010) additionally indicates that credit unions have savings of \$1,229.4 billion, make loans of \$960.1 billion and have reserves of \$131.7 billion. This suggests that worldwide in 2010, the average loan to asset ratio was 65.7% and the average reserve to asset ratio was 9.01%.

- 2.3.2 Some insights into patterns of credit union development can be uncovered with the aid of organisational life-cycle theory which assumes that credit unions follow an evolutionary development path that can be partitioned into distinct phases of growth: Nascent (formative), Transition and Matureⁱⁱⁱ. Credit unions positioned within each of these stages can be characterised by various financial and organisational attributes.^{iv} This is shown on a country-specific basis in Table 1 (overleaf).
- 2.3.3 Credit union movements at a nascent stage of development tend to have a small asset size, high levels of structural regulation, a tight common bond, a heavy reliance on volunteers and provide basic savings and loans products. Transition movements are characterised by large asset size, evolving regulatory and supervisory frameworks, fewer common bond restrictions, higher levels of product diversification, development of professional trade associations, less reliance on volunteers, development of central services and a greater emphasis on growth and efficiency. Finally, mature movements have large asset size, have undergone structural deregulation accompanied by increased prudential regulation, have support mechanisms in place, have a loose common bond, diversified product portfolios, professionalisation of senior management, centralised services including liquidity support mechanisms and adoption of electronic technologies.
- 2.3.4 At the present time, nascent industries can be found primarily in the developing countries of Africa, Asia and the former Soviet bloc. In these regions, they are often seen as vehicles for reducing poverty within more general microfinance programs. There are, of course, notable exceptions such as Poland and Lithuania where credit union development has been rapid over the last decade with credit unions in these countries extending financial services to the general population. From Table 1 we note that in terms of assets, membership and population penetration the movements in the US, Australia and Canada are viewed as mature. The interim stage between nascent and maturity is that of transition. The earlier mentioned movements in Poland and Lithuania could be viewed as in the transition stage as is the movement in Great Britain. It can take about 20 years for a movement to develop from transition to maturity.
- 2.3.5 Ireland is also classified in the transition stage although it has an extremely high penetration level, (67%).^v That Ireland is not identified as a mature movement is due to many factors including limited product development, the failure to evolve the regulatory and prudential frameworks, failure to adopt an integrated IT system for the delivery of services and limited centralised service support.

³ World Council of Credit Unions (WOCCU) is the global trade association and development agency for credit unions. For more information, see <http://www.woccu.org/>

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Table 1 Geographic Location and Classification, 2010

| Country/Region | No. of Credit Unions | Membership | Assets (\$ million) | Penetration ¹ (%) |
|-----------------------------------|----------------------|-------------|---------------------|------------------------------|
| Mature Credit Unions | | | | |
| United States of America | 7,491 | 91,758,307 | 926,610 | 44 |
| Canada | 877 | 10,763,934 | 256,187 | 46 |
| Australia | 105 | 3,400,000 | 53,420 | 23 |
| South Korea | 963 | 5,578,995 | 42,200 | 16 |
| Transitional Credit Unions | | | | |
| Kenya | 4,020 | 3,918,490 | 3,703 | 17 |
| Hong Kong | 44 | 74,086 | 908 | 1 |
| ROC Taiwan | 336 | 203,767 | 743 | 1 |
| Sri Lanka | 8,440 | 895,132 | 59 | 6 |
| Singapore | 31 | 225,725 | 929 | 6 |
| Thailand | 2,339 | 3,621,119 | 37,984 | 8 |
| Ireland | 409 | 2,955,000 | 20,052 | 67 |
| Great Britain | 480 | 891,283 | 1,191 | 2 |
| Poland | 59 | 2,176,541 | 4,728 | 8 |
| Fiji | 29 | 15,243 | 25 | 3 |
| New Zealand | 29 | 184,937 | 478 | 6 |
| Caribbean | 447 | 2,805,296 | 4,805 | 17 |
| Latin America | 1,745 | 15,678,012 | 48,124 | 5 |
| Nascent Credit Unions | | | | |
| Africa ² | 13,541 | 13,627,90 | 2,167 | 8 |
| Asia ³ | 10,009 | 27,201,231 | 56,603 | 3 |
| Russia | 130 | 207,710 | 162 | - |
| Ukraine | 679 | 1,631,300 | 414 | 5 |
| Worldwide (100 countries) | | | | |
| All countries | 52,945 | 187,986,967 | 1,460,552 | 8 |

Source: World Council of Credit Unions (Raw Statistical Data, 2010)

¹The penetration rate is calculated by dividing the total number of reported credit union members by the economically active population.

²The regional total for Africa does not include Kenya, which is classed as a transitional credit union industry.

³The regional total for Asia does not include Korea, which is classed as a mature credit union country or Hong Kong, Singapore, Sri Lanka, ROC Taiwan and Thailand which are classed as transitional credit union countries.

- 2.3.6 The typology contains an assumption about a development path for credit unions albeit that within any one credit union movement, at a given moment in time, individual credit unions may not be, nor want to be, at the same stage of development. The typology emphasises maturity as being the most advanced stage of credit union development. However, it must also be recognised that there is nothing, in theory, to prevent a further stage beyond maturity which entails the transformation of credit unions beyond their current co-operative form to an entirely new form of organisation through, for example, demutualisation^{vi}. However, the output of such a stage would render the institutions no longer credit unions and the Commission does not consider

this form as appropriate or necessary.

- 2.3.7 More recently the declining fortunes of the Irish economy have not only put an additional brake on credit union development but arguably have resulted in a significant regression. For some credit unions their business model is now under pronounced pressure due to falling consumer expenditure and a rising unemployment rate. Personal consumer expenditure fell by 1.1% in 2008, 6.9% in 2009, 0.8% in 2010, 2.5% in 2011 and is projected to fall by 2.0% in 2012 before rising by 0.5% in 2013 (IBEC, January 2012) while the unemployment rate increased to 6.3% in 2008, 11.8% in 2009, 13.6% in 2010, 14.4% in 2011 and is forecast to be 14.0% in 2012 and 13.3% in 2013 (IBEC, January 2012).

2.4 Historical Development^{vii}

- 2.4.1 In Ireland, the first credit unions were formed in 1958. A year later there were three credit unions with a total of 200 members and €530 in savings. In 1960, the Credit Union League of Ireland was established to foster the growth of credit unions. The League then evolved into the Irish League of Credit Unions (ILCU).^{viii} By 1962, there were 18 credit unions, and this figure grew exponentially during the 1960s.
- 2.4.2 Throughout the 1970s and 1980s, there was continual growth in credit union numbers, members and savings. In 1984, there were 389 credit unions, with 527,000 members and €293 million in savings. Since the late 1980s, there has been a levelling off in the establishment of new credit unions, although strong growth, both in savings and membership, has continued. During the 1990s, there were, on average, three new credit unions formed per annum, with no new credit unions established after 1999. At the end of 1996, there were 434 credit unions with a membership of 1.7 million and savings of €2,267 million.
- 2.4.3 By 2000, the comparative figures were 438 credit unions, 2.2 million members and savings of €4,618 million. In 2003, the Credit Union Development Association (CUDA) was formed “as a response to a more competitive and increasingly complex business environment” and, now it has 12 member credit unions. By 2004, credit union numbers had fallen to 424, but savings continued to grow and stood at approximately €9,336 million while membership increased to 2.6 million. By December 2011 there was a further fall in credit union numbers to 404 but savings had increased to €11,895 million and membership to approximately 2.9 million.

2.5 Legislative and Supervisory Framework

- 2.5.1 The Credit Union Act 1966 provided the first legislative framework for the credit union movement in Ireland. Under the 1966 Act, the Registrar of Friendly Societies was designated as the regulatory authority for credit unions. This Act was repealed with the enactment of the Credit Union Act 1997.
- 2.5.2 The 1997 Act established a Registrar of Credit Unions. The 1997 Act included a relaxation of common bond definitions, an increase in the duration and amount of savings and loans allowed and also permitted credit unions to provide additional services. The 1997 Act also addressed other key issues:

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- registration and membership
- operation of credit unions
- management of credit unions
- meetings and resolutions
- control and supervision of credit unions by the Registry of Credit Unions
- accounts and audit
- disputes and complaints
- amalgamations and transfers of engagements
- winding up
- appointment of credit union administrator
- appointment of examiner
- offences and civil proceedings

2.5.3 The establishment in 2003 of the Irish Financial Services Regulatory Authority, as the sole regulatory authority for all financial service providers, resulted in the credit union sector moving from a largely self-regulated sector to a regulatory regime consistent with other financial services providers. In 2010, the creation of a unitary Central Bank of Ireland with responsibilities for central banking and financial regulation meant that credit unions are now regulated and supervised by the Registrar of Credit Unions within the Central Bank. While it is important that the credit union movement has a legislative framework that is appropriate for credit unions, in recent years, as the reaction of the Irish government to the financial crisis has developed, credit unions have come within the scope of significant new and proposed pieces of legislation: Financial Services (Deposit Guarantee Scheme) Act 2009, Central Bank Reform Act 2010, Central Bank and Credit Institutions (Resolution) Act 2011 and the Central Bank (Supervision and Enforcement) Bill 2011. The Commission considers that this approach, which also applies to Government decisions on transposition of European Union Directives, must be monitored carefully to ensure the credit union difference is not diluted and lost. An objective of the Commission is to seek solutions to evolving and developing the credit union movement in line with its ethos and guiding principles.

2.6 Current Role of Credit Unions in the Provision of Credit

2.6.1 Table 2 (overleaf) contains a summary aggregate balance sheet for credit institutions in Ireland at September 2011. Total assets/liabilities stood at €1,046bn. Irish resident loans exceed Irish resident deposits with loans to Irish households exceeding deposits by Irish households by 40%. This is in contrast to the position for credit unions where loans are 48% of deposits.

2.6.2 In aggregate terms, the credit union sector is small; however, it is big in its niche. The significance of the sector emerges upon detailed examination of the nature of the loan credit data to the household sector contained in Table 3. The bulk of outstanding credit for loans is for durations in excess of five years with 75% borrowed for housing purposes. There is unlikely to be much credit union activity in this majority area of personal credit activity given restrictions on the scope of credit union operations. In fact, of the €6bn loan book that credit unions lend to Irish households, 84% were for

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residual maturity of less than 5 years⁴. Table 2 shows that credit union loans make up only 4% of aggregate loans to Irish households. However, given that the total amount of loans advanced to the Irish Household Sector for durations less than five years amounted to €22bn, credit unions may be significant players in the niche of the market where most of their loan activity is concentrated.

Table 2 Credit Institutions (Ireland) Aggregate Balance Sheet, September 2011 (€bn)

| Assets | 1,046 | Liabilities | 1,046 |
|--------------------------------|--------------|-----------------------------|--------------|
| Loans to Irish Resident | 407 | Deposits by Irish residents | 282 |
| Of which to Private Sector | 261 | Of which Private sector | 164 |
| Of which to Households | 128 | Of which Households | 92 |
| Of which made by Credit Unions | 6 | Of which in Credit Unions | 12 |
| Loans to Non-Residents | 313 | Non-resident Deposits | 308 |
| Securities | 248 | Securities | 101 |
| Central Bank Balance | 8 | Capital & Reserves | 131 |
| Remaining Assets | 69 | Eurosystem Borrowing | 100 |
| | | Remaining Liabilities | 125 |

Source: Central Bank of Ireland, Monthly Banking Statistics, A Tables (rounded) and Central Bank Prudential Returns September 2011

Table 3 Loan Credit Advanced to the Irish Household Sector, September 2011, €bn

| Total 128 | | | |
|--------------------------------|-----|-------------------------------|----|
| Composition by Duration | | Composition by Purpose | |
| Less than 1 year | 7 | Housing | 98 |
| 1 to 5 years | 15 | Consumer Credit | 17 |
| More than 5 years | 107 | Other Loan | 13 |

Source: Central Bank of Ireland, Monthly Banking Statistics, A Tables (rounded)

2.6.3 In examining the nature of competition between the credit unions and the larger financial institutions (banks) it is useful to characterise it in terms of a single product/service entity competing with a multi-product/service entity. Credit unions operate predominantly in the market for shorter term loans to Irish households. The banks cover this market and in addition the markets for long term loans to Irish households, loans to non-residents, and loans to the non-financial Irish private sector (outstanding value of €98 billion in September 2011).

2.6.4 Bank customers typically buy a variety of loan products. It is therefore possible for banks to cross subsidise one product with another, i.e. to use a loss leader strategy. This could manifest itself in a number of ways. For example, the short-term personal loan market segment may attract “free banking”. This provides a major competitive advantage for banks over credit unions.

2.6.5 In the next Chapter, it will be shown that the sector was under-lent in the year to

⁴ It should be noted that credit unions report loans based on residual maturity while other credit institutions report loans based on original maturity.

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September 2011 with a loan to asset ratio of 42% (This decreased further to 41% in December 2011). The sector has significant investment holdings with income from investments accounting for 26% of total income on average in the period 2006 to 2010. There is a high risk profile associated with this income source and the lower average return on investments in this period has resulted in lower returns for credit unions than would have been the case had more income come from loans.

- 2.6.6 There may be a number of factors leading to credit unions being under-lent to such an extent. This could be the result of competition from banks, crowding the sector out of its niche market segment resulting in assets being put into risky investment portfolios.
- 2.6.7 There is no great evidence that, in the period 2006 to 2009, credit unions rationed loans. Indeed evidence from loan provisioning would suggest the opposite. On the other hand, the market share of the credit union sector in non-mortgage consumption lending fell continuously from 2003 to the onset of the financial crisis in 2008. Competition from other financial providers therefore appears to have had an effect on the demand for loans from credit unions.
- 2.6.8 The Interim Report of the Commission made strong recommendations with regard to regulation and governance driven by a concern for the protection of deposits. This is appropriate and these matters are further developed in this Report. However, prudence alone will not deliver sustainability if the rate of return on assets is suffering as a result of an unbalanced competitive environment.
- 2.6.9 The Commission was asked to address the question of the credit unions competing with the larger financial institutions. In their submission to the Commission, the Irish Banking Federation expressed concern lest extension in the scope of credit unions might be accompanied by competitive advantage to the sector vis-a-vis the banks. The analysis above suggests a case for arguing that the sector has suffered from a competitive disadvantage in this context. It is important, then, to ensure that the conditions for balanced competition prevail following restructuring of the Irish financial services system.
- 2.6.10 The vision for the Irish financial system is that it will be led by two multi-product domestic pillar banks with the hope that a third pillar might be provided by a foreign bank.⁵ In this scenario, there is a greater level of concentration among the providers of private sector credit. With concentration comes the potential to exploit dominance, with higher charges to consumers for credit products. This in turn contributes to bank profitability and improves the prospects for disposing of the State's holding in these banks.
- 2.6.11 The evolving structure of the banking system is likely to create competitive space for credit unions to expand loans in their niche market in the next few years. However, greater competition is likely to develop in banking in the medium term. This will be all the more likely if the third pillar emerges, as anticipated, from abroad. In this scenario the type of crowding out for credit unions that was present during much of the last

⁵ John A. Moran. "Restructuring of the Irish Banking System". Department of Finance, March 31st 2011. <http://www.finance.gov.ie/documents/pressreleases/2011/mn001presrev.pdf>

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decade could re-emerge⁶.

- 2.6.12 Sustainability for credit unions in a more competitive environment would be enhanced to the extent that there is an extension in the range of products that credit unions can offer⁷.
- 2.6.13 Trend surveys in the United States suggest the traditional credit union market niche as being the least dynamic⁸. Half of the credit unions surveyed believed that secured or unsecured non-credit card consumer loans would either not grow or decline. In contrast, 48% predicted that the growth rate for used car loans would exceed 10% with many of these loans originated through third parties. Other loan types most frequently predicted to grow by more than 10% are; business and agriculture (38%), first mortgages (35%) and home equity (30%).
- 2.6.14 The Commission believes that there is future scope to expand the product range of credit unions. In addition, it considers that the mutual nature of credit unions possesses many attractions when engaging in mortgage lending and possibly micro enterprise.
- 2.6.15 Any extension of the loan product range however, must be balanced with the nature and call profile of deposits, the capacity of credit unions to undertake additional types of lending and the introduction of an appropriate regulatory framework. These issues are addressed in detail in Chapter 7.

2.7 Summary

From the analysis the following points emerge:

- 2.7.1 Credit unions are self-help financial co-operatives that pursue the economic and social goals of members and wider local communities.
- 2.7.2 In credit unions there is a coincidence of ownership and consumption which translates into a reduced potential for conflict and less incentive for risk-taking behaviour in comparison to, for example, for-profit shareholder based financial institutions. In part, this explains why credit unions (worldwide) have fared better than banks during the financial crisis.
- 2.7.3 In Ireland, credit unions are important players in the provision of financial services, with membership of credit unions accounting for a greater share of the total population than in almost any other country.

⁶ The dominant players will set the ceiling on the price of credit in the credit unions niche market segment. In the anticipated duopoly setting this is likely to be high thereby affording plenty of scope for credit unions. In a more competitive setting the price could be dropped significantly, even going below average cost.

⁷ There is also the question of the role that might be played by the Competition Authority in ensuring that dominant players are not engaging in price fixing or exploitation of their dominant position. It is natural, at this time that the focus of policy is on stricter regulation. In time there will emerge a greater concern about the framework for competition. This broader question is outside the remit of the Commission. For this reason, the Commission will focus its recommendations on ways in which competition can be balanced by enhancing the potential product range for credit unions.

⁸ Credit Strategies and Trends. CUNA Mutual Group. June 2011.

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- 2.7.4 The number of credit unions has remained broadly constant over the last two decades. This contrasts with the experience in credit union movements elsewhere. Contraction in other countries has occurred through transfers of engagements, amalgamations and liquidation.
- 2.7.5 The credit union movement in Ireland has not as yet progressed beyond a transition stage of development. In part this centres on limited product development, a limited centralised service support system and a less well developed prudential framework.
- 2.7.6 Credit unions are niche players in the retail financial services industry. Sustainability requires a concern for ensuring balanced competition with the larger financial institutions in addition to ensuring that the regulatory environment is fit for purpose.
- 2.7.7 Credit unions, where appropriate, ought to be allowed to expand the range of product offerings. In that building societies no longer occupy a significant position in household credit, there is an opportunity for the development of services by credit unions as a mutual alternative to the two pillar banks.

Chapter 3 – Current Financial Position of the Credit Union Sector in Ireland

3.1 Introduction

3.1.1 The Chapter provides a sector review of the Irish credit union movement for the period 2006 to 2011. Where possible, the most up-to-date information is provided (December 2011 unaudited prudential returns). Where it proves necessary to use information from annual returns the most comprehensive available data is for September 2010. The September 2010 returns are used when nominal values are presented. Where information can be presented in ratio form data from the September 2011 annual returns are used (only 318 credit unions have as yet submitted their 2011 returns)⁹.

3.1.2 Not surprisingly, in recent times adverse financial and economic conditions in Ireland have created significant challenges for all financial institutions including credit unions. By considering this period the Commission is in a position to examine how the sector has fared both prior to the financial crisis and throughout the present economic downturn. This analysis is designed to identify the financial strengths and weaknesses of the sector and to frame the Commission's work on appropriate prudential management, regulatory and governance frameworks. The data upon which the analysis is based was provided to the Commission on Credit Unions by the Central Bank.¹⁰

3.2 Asset Distribution

3.2.1 Table 1 (overleaf) describes the credit union sector in terms of asset size. Of the 404 credit unions in Ireland (December 2011), more than half (211) have assets less than €20m and almost three-quarters have assets less than €40m (295 credit unions). Only 29 credit unions have assets in excess of €100m of which 4 have assets in excess of €200m. When the average asset sizes of community and industrial credit unions are compared there are no great differences. However, it is worth noting that industrial credit unions are more likely than community credit unions to be either small (have assets of less than €20m) or large (have assets greater than €100m) and that while 8% of community credit

⁹ Annual return data from the 2011 audited accounts were used in the analysis of cost to income ratios, dividends and returns on assets throughout this Chapter. Given that only 318 credit unions had submitted their annual returns for 2011 at the time of writing, it is likely that these figures would change. Where ratios are provided in a table for an asset category/all credit unions, the ratio is the average of the ratios for each credit union that falls within the category or the average of ratios for all credit unions.

¹⁰ In providing the data, the Registrar wishes to note that (1) there are limitations in relying on the numbers reported given the structural weakness the Registrar has identified in governance, management accounting and reporting systems in the credit union sector; (2) the information provided from the Prudential Returns submitted by credit unions is management account information and is unaudited; (3) there is a concern that the arrears figures reported on the Prudential Return may not fully reflect the actual position; (4) the Reserve figures reported for 2011 may be overstated as in some cases they will not reflect the final year-end position regarding bad debt provisions and investment valuations until after audits are completed and year-end accounts finalised. In addition for some credit unions the reserves figure may include dividends which have not yet been paid; (5) the 2010 Credit Union Annual Return does not contain information for a number of credit unions with balance sheets showing significant solvency stress; and (6) that there is a lag in the impact of the difficulties being encountered by credit unions on the reserve position in credit unions.

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unions have assets between €60m and €100m, no industrial credit union falls into these asset size categories. Over the period September 2006 to December 2011, we note a decline in credit union numbers from 425 to 404 representing a fall in the number of industrials from 58 to 47 and in community credit unions from 367 to 357. In terms of credit unions within the respective size bands there is little change over the period, with the exception of the category less than €20m which has seen a drop in numbers of 19 (from 230 to 211).

- 3.2.2 Table 2 compares the share of total assets by asset size (December 2011). The general pattern is one in which the more numerous smaller credit unions account for a disproportionately small share of total assets while the few large credit unions account for a disproportionately large share. Despite accounting for more than half of the number of credit unions, those with assets of less than €20m account for just 15.2% of total assets. Along similar lines, while almost three-quarters of credit unions have assets of €40m or less, they account for a third of total assets. At the other end of the scale, though small in number, those credit unions that have assets of €100m or more account for approximately a third of total assets.

3.3 Income

- 3.3.1 Table 3 details total income as well as its individual components. The income of credit unions has varied from year to year; it peaked in 2007 at €860.4m prior to the onset of the financial crisis and in 2010 stood at €772.42m. The principal component of credit union income is interest income which on average accounts for 71% of total income, with investment income, on average, accounting for approximately 27%. Between 2006 and 2009, income from interest payments increased from €572.88m to €613.52m (an increase of 7%) before falling sharply in 2010 to €546.47m (a decrease of 11%). This decline between 2009 and 2010 is of such a magnitude that it takes interest income to a level lower than what it was in 2006. This decline has occurred for credit unions in all size categories.
- 3.3.2 Credit union income from investments has been more variable. The best year for credit unions' investments was 2007 when income from this source was €256.95m. Investment income in 2010 was €207.76m, somewhat similar to the 2009 figure and a 19% fall from its 2007 peak. Again, all asset size categories have experienced investment income deterioration.

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Table 1 Asset Categorisation

| SECTOR | 30 Sep 2006 | 30 Sep 2007 | 30 Sep 2008 | 30 Sep 2009 | 30 Sep 2010 | 30 Sep 2011 | 31 Dec 2011 |
|--------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Greater than €100m | 29 | 29 | 28 | 28 | 29 | 30 | 29 |
| €60m to €100m | 35 | 35 | 35 | 35 | 33 | 29 | 30 |
| €40m to €60m | 46 | 47 | 48 | 48 | 51 | 50 | 49 |
| €20m to €40m | 85 | 86 | 82 | 85 | 81 | 84 | 84 |
| Less than €20m | 230 | 223 | 225 | 219 | 215 | 213 | 211 |
| Grand Total | 425 | 420 | 418 | 415 | 409 | 406 | 403 |
| COMMUNITY | | | | | | | |
| Greater than €100m | 21 | 21 | 20 | 20 | 21 | 21 | 20 |
| €60m to €100m | 34 | 34 | 34 | 34 | 32 | 29 | 30 |
| €40m to €60m | 41 | 44 | 45 | 44 | 47 | 46 | 45 |
| €20m to €40m | 78 | 77 | 73 | 77 | 73 | 76 | 76 |
| Less than €20m | 193 | 189 | 193 | 189 | 188 | 186 | 186 |
| Grand Total | 367 | 365 | 365 | 364 | 361 | 358 | 357 |
| INDUSTRIAL | | | | | | | |
| Greater than €100m | 8 | 8 | 8 | 8 | 8 | 9 | 9 |
| €60m to €100m | 1 | 1 | 1 | 1 | 1 | 0 | 0 |
| €40m to €60m | 5 | 3 | 3 | 4 | 4 | 4 | 4 |
| €20m to €40m | 7 | 9 | 9 | 8 | 8 | 8 | 8 |
| Less than €20m | 37 | 34 | 32 | 30 | 27 | 27 | 25 |
| Grand Total | 58 | 55 | 53 | 51 | 48 | 48 | 46 |

Notes: All Data extracted from the Credit Union Annual Return for 2006 to 2010 (Audited). All 2011 data is extracted from the Prudential Return (UNAUDITED). There are 404 credit unions as of 31 December 2011 but 1 credit union has not submitted a prudential return for Dec 2011 at the time of analysis, hence the number reported in Table 1 is 403 for all credit unions.

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Table 2 Credit Unions by Asset Size – December 2011

| SECTOR | No. of Credit Unions | % of Credit Unions | Total Assets €m | % Total Assets |
|--------------------|----------------------|--------------------|------------------|----------------|
| Greater than €100m | 29 | 7.2% | 4,528.78 | 32.9% |
| €60m to €100m | 30 | 7.4% | 2,288.72 | 16.6% |
| €40m to €60m | 49 | 12.2% | 2,397.05 | 17.4% |
| €20m to €40m | 84 | 20.8% | 2,476.94 | 18.0% |
| Less than €20m | 211 | 52.4% | 2,092.14 | 15.2% |
| Total | 403 | 100.0% | 13,783.62 | 100.0% |
| | | | | |
| COMMUNITY | No. of Credit Unions | % of Credit Unions | Total Assets €m | % Total Assets |
| Greater than €100m | 20 | 5.0% | 2,826.46 | 20.5% |
| €60m to €100m | 30 | 7.4% | 2,288.72 | 16.6% |
| €40m to €60m | 45 | 11.2% | 2,197.02 | 15.9% |
| €20m to €40m | 76 | 18.9% | 2,248.65 | 16.3% |
| Less than €20m | 186 | 46.2% | 1,967.41 | 14.3% |
| Total | 357 | 88.6% | 11,528.26 | 83.6% |
| | | | | |
| INDUSTRIAL | No. of Credit Unions | % of Credit Unions | Total Assets €m | % Total Assets |
| Greater than €100m | 9 | 2.2% | 1,702.32 | 12.4% |
| €60m to €100m | 0 | 0.0% | 0.00 | 0.0% |
| €40m to €60m | 4 | 1.0% | 200.03 | 1.5% |
| €20m to €40m | 8 | 2.0% | 228.29 | 1.7% |
| Less than €20m | 25 | 6.2% | 124.72 | 0.9% |
| Total | 46 | 11.4% | 2,255.36 | 16.4% |

Notes: December 2011 data is extracted from the Prudential Return (UNAUDITED)

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Table 3 Credit Union Income – 2006 to 2010

| | 30 Sept 2006 | 30 Sept 2007 | 30 Sept 2008 | 30 Sept 2009 | 30 Sept 2010 |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Interest Income | | | | | |
| Greater than €100m | €171.63m | €172.76m | €179.67m | €180.61m | €173.00m |
| €60m to €100m | €105.03m | €109.36m | €112.20m | €110.94m | €89.76m |
| €40m to €60m | €91.16m | €90.97m | €98.30m | €101.58m | €93.28m |
| €20m to €40m | €111.43m | €114.76m | €114.34m | €117.68m | €98.53m |
| Less than €20m | €93.64m | €96.32m | €103.51m | €102.69m | €91.90m |
| Total | €572.88m | €584.17m | €608.02m | €613.52m | €546.47m |
| Investment Income* | | | | | |
| Greater than €100m | €82.34m | €97.78m | €73.56m | €69.78m | €76.39m |
| €60m to €100m | €37.67m | €47.54m | €40.49m | €44.02m | €41.30m |
| €40m to €60m | €27.57m | €37.53m | €26.72m | €36.37m | €35.72m |
| €20m to €40m | €32.59m | €43.13m | €32.37m | €34.18m | €30.65m |
| Less than €20m | €21.07m | €30.97m | €21.99m | €22.87m | €23.70m |
| Total | €201.24m | €256.95m | €195.12m | €207.22m | €207.76m |
| Other Income** | | | | | |
| Greater than €100m | -€3.63m | -€2.68m | -€0.26m | €8.19m | €1.63m |
| €60m to €100m | €5.77m | €7.24m | €1.27m | €2.52m | €1.79m |
| €40m to €60m | €4.11m | €6.15m | -€0.32m | €6.63m | €5.21m |
| €20m to €40m | €3.71m | €2.64m | €2.74m | €4.32m | €5.30m |
| Less than €20m | €4.14m | €5.93m | €3.39m | €5.35m | €4.26m |
| Total | €14.14m | €19.32m | €6.86m | €27.05m | €18.22m |
| Total Income | | | | | |
| Greater than €100m | €250.34m | €267.86m | €252.97m | €258.58m | €251.02m |
| €60m to €100m | €148.47m | €164.15m | €153.96m | €157.49m | €132.86m |
| €40m to €60m | €122.84m | €134.66m | €124.69m | €144.58m | €134.21m |
| €20m to €40m | €147.73m | €160.53m | €149.45m | €156.19m | €134.47m |
| Less than €20m | €118.85m | €133.21m | €128.89m | €130.91m | €119.86m |
| Total | €788.23m | €860.40m | €809.96m | €847.75m | €772.42m |
| Number of Credit Unions | 425 | 420 | 418 | 415 | 392*** |

Notes: All Data extracted from the Credit Union Annual Return for 2006 to 2010 (Audited);

* Investment Income does not include investment losses.

**Other Income includes Members Deposit and Other Interest Expense and Similar Charges.

***For 2010, the data excludes 17 Credit Unions who had not submitted an Annual Return.

3.4 Costs

- 3.4.1 Table 4 examines credit union costs by outlining bad debt provisions, loans written off and investment losses. Between 2006 and 2010, credit union total costs have almost doubled, from €321.51m to €626.77m (increase of 94.95%). The increase occurred across all size bands; although credit unions with assets between €40m and €60m experienced

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the greatest percentage increase, of 121.2%, while credit unions with assets between €60m and €100m had the smallest at 74.5%.

- 3.4.2 The increase in costs is primarily associated with increases in both bad debt provisions and loans written off. While both of these costs began to increase in 2008, they grew substantially in 2009 and 2010. In 2008, the credit union sector made additional provisions of €38.28m for bad debts, however, bad debt provisions increased by €157.49m in 2009 and €215.06m in 2010 in recognition of a continued decline in the quality of the loan book. With regard to loans written off, in 2008, this accounted for €41.85m, but rose to €87.95m in 2009 and €107.44m in 2010 (1.7% of gross loans). Again the problem spans all asset categories.

Table 4 Credit Union Costs – 2006 to 2010

| | 30 Sept 2006 | 30 Sept 2007 | 30 Sept 2008 | 30 Sept 2009 | 30 Sept 2010 |
|--|-------------------|------------------|------------------|-------------------|-------------------|
| Bad Debt Provisions | | | | | |
| Greater than €100m | €8.72m | €12.96m | €10.57m | €45.06m | €63.51m |
| €60m to €100m | €9.36m | €8.63m | €8.78m | €32.86m | €43.58m |
| €40m to €60m | €3.69m | €2.40m | €6.01m | €26.79m | €36.52m |
| €20m to €40m | €6.52m | €6.23m | €6.60m | €26.33m | €39.60m |
| Less than €20m | €3.27m | €5.00m | €6.32m | €26.44m | €31.85m |
| Total | €31.56m | €35.22m | €38.28m | €157.49m | €215.06m |
| Loans Written Off | | | | | |
| Greater than €100m | €11.38m | €9.86m | €11.32m | €22.30m | €29.35m |
| €60m to €100m | €7.80m | €9.06m | €8.52m | €13.89m | €17.11m |
| €40m to €60m | €6.45m | €7.92m | €7.25m | €16.99m | €21.50m |
| €20m to €40m | €6.61m | €7.59m | €7.58m | €17.83m | €20.41m |
| Less than €20m | €5.47m | €5.68m | €7.18m | €16.94m | €19.07m |
| Total | €37.71m | €40.11m | €41.85m | €87.95m | €107.44m |
| Investment Losses | | | | | |
| Greater than €100m | €0.21m | €0.51m | €25.78m | -€4.98m | €4.61m |
| €60m to €100m | €0.24m | €2.49m | €15.87m | €4.30m | €2.28m |
| €40m to €60m | €0.03m | €1.72m | €10.78m | €3.98m | €0.12m |
| €20m to €40m | €0.31m | €0.69m | €11.04m | €7.10m | €1.06m |
| Less than €20m | €0.03m | €0.51m | €9.52m | €7.05m | €0.34m |
| Total | €0.83m | €5.93m | €72.99m | €17.46m | €8.40m |
| Total Costs | | | | | |
| Greater than €100m | € 87.43 m | € 101.44 m | € 123.08 m | € 142.25 m | € 183.79 m |
| €60m to €100m | € 66.28 m | € 72.94 m | € 93.04 m | € 112.48 m | € 115.67 m |
| €40m to €60m | € 50.04 m | € 55.80 m | € 73.88 m | € 102.56 m | € 110.69 m |
| €20m to €40m | € 64.98 m | € 70.01 m | € 82.50 m | € 112.14 m | € 115.57 m |
| Less than €20m | € 52.77 m | € 58.44 m | € 76.12 m | € 101.91 m | € 101.06 m |
| Total | € 321.51 m | € 358.62m | € 448.61m | € 571.33 m | € 626.77 m |
| No of Credit Unions Reporting (I&E) | 425 | 420 | 418 | 415 | 392* |

Notes: All Data extracted from the Credit Union Annual Return for 2006 to 2010 (Audited);

* For 2010, the data excludes 17 Credit Unions who had not submitted an Annual Return.

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- 3.4.3 Investment losses are also detailed in Table 4. This problem reached a peak in 2008 (€72.99m) and since then losses have been reduced - €17.46m in 2009 and €8.40m in 2010.
- 3.4.4 In Table 5, information is presented on the cost-to-income ratios of the sector as a whole and for the respective size categories. Given the decline in income (Table 3) and the increase in costs (Table 4) it should be no surprise to see that the cost-to-income ratio has increased considerably over the period, 49.5% in 2006 to 88.7% in 2011. The increase occurs across all size bands although credit unions with assets in excess of €100m had a consistently lower cost to income ratio than the other size categories. The information in Table 5 clearly highlights the year-on-year added pressures that credit unions are subject to.

Table 5 Cost to Income Ratios – 2006 to 2011

| Total Cost / Income Ratio | 30 Sept 2006 | 30 Sept 2007 | 30 Sept 2008 | 30 Sept 2009 | 30 Sept 2010 | 30 Sept 2011 |
|-------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Greater than €100m | 35.6% | 38.4% | 49.8% | 54.2% | 73.6% | 78.1% |
| €60m to €100m | 44.5% | 44.9% | 61.6% | 72.5% | 87.2% | 91.9% |
| €40m to €60m | 40.6% | 41.2% | 63.2% | 70.4% | 82.6% | 87.7% |
| €20m to €40m | 44.4% | 43.7% | 71.3% | 72.9% | 86.2% | 88.3% |
| Less than €20m | 55.8% | 45.4% | 60.3% | 78.7% | 83.1% | 90.3% |
| Total | 49.5% | 44.0% | 62.2% | 74.4% | 83.3% | 88.7% |

Notes: All Data extracted from the Credit Union Annual Return for 2006 to 2010 (Audited);
For 2010, the data excludes 17 Credit Unions who had not submitted an Annual Return;
For 2011, the data excludes 86 Credit Unions who had not submitted an Annual Return.

3.5 Arrears Over 9 Weeks and Provisions

- 3.5.1 The opportunity is taken in Table 6 to explore in detail arrears over nine weeks (information is also detailed on provisions). There has been a significant increase in the percentage of the gross loan book in arrears over nine weeks. This increase in arrears over nine weeks is associated with more recent years. Over the first three years of the period, the percentage of the gross loan book in arrears was reasonably stable, increasing from 6.3% in 2006 to 6.68% in 2008. However, since 2008 there has been a very dramatic increase in loan book arrears; 9.85% in 2009 to 15.15% in 2010 to 19.27% in 2011. There are currently 99 credit unions each having arrears over 25% of their gross loan books.
- 3.5.2 As a whole, the credit union sector has increased its provisioning for bad debts from €204.9m in 2006 to €800.78m in 2011. Provisions are set aside to deal with expected losses while reserves are intended for unexpected losses. The 2011 provisions fall short of the total arrears in the sector of €1,021.2m. That said, it is worth noting that in 2006 the amount set aside for provisions was about half of the amount in arrears (€380.44m), and while the nominal sums have increased, in 2011 about 80% of the arrears are

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provided for¹¹. However, while the overall sector may appear to be better prepared to absorb unforeseen losses in 2011 than it was in 2006, what the aggregate does not show is the relationship between provisioning and levels of arrears at the individual credit union level. In other words, not all credit unions may be better prepared in 2011 than they were in 2006.

Table 6 Arrears and Provisions – 2006 to 2011

| | 30 Sept 2006 | 30 Sept 2007 | 30 Sept 2008 | 30 Sept 2009 | 30 Sept 2010 | 30 Sept 2011 | 31 Dec 2011 |
|------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-------------------|
| Arrears | | | | | | | |
| Greater than €100m | €99.34m | €105.26m | €126.90m | € 176.06m | € 251.42m | € 270.10m | €272.84m |
| €60m to €100m | €83.16m | €84.78m | €98.95m | €139.99m | €169.62m | €65.92m | €174.98m |
| €40m to €60m | €64.61m | €66.17m | €77.43m | €103.24m | €147.88m | €188.91m | €192.74m |
| €20m to €40m | €72.47m | €70.70m | €77.97m | €118.32m | €151.31m | €210.28m | €214.62m |
| Less than €20m | €60.86m | €61.61m | €76.81m | €106.43m | €140.06m | €161.25m | €166.04m |
| Total | €380.44m | €388.51m | €458.07m | €644.05m | €860.27m | €996.46m | €1,021.22m |
| Provisions | | | | | | | |
| Greater than €100m | €60.61m | €72.71m | €77.39m | € 118.67 m | €182.69m | €212.59m | €237.68m |
| €60m to €100m | €48.62m | €52.93m | €62.26m | €91.81m | €111.57m | €118.77m | €131.49m |
| €40m to €60m | €30.36m | €37.14m | €45.72m | €72.95m | €100.37m | €139.46m | €147.08m |
| €20m to €40m | €36.28m | €40.54m | €43.48m | €70.79m | €95.19m | €156.82m | €162.24m |
| Less than €20m | €29.04m | €33.78m | €40.68m | €65.31m | €87.99m | €115.83m | €122.28m |
| Total | €204.90m | €237.10m | €269.54m | €419.53m | €577.81m | €743.48m | €800.78m |
| Average Arrears | | | | | | | |
| Greater than €100m | 5.36% | 5.62% | 6.38% | 9.14% | 13.34% | 15.04% | 16.14% |
| €60m to €100m | 6.74% | 6.43% | 7.21% | 10.88% | 16.88% | 19.07% | 19.89% |
| €40m to €60m | 6.07% | 5.93% | 6.34% | 9.17% | 14.41% | 18.44% | 19.91% |
| €20m to €40m | 5.99% | 5.50% | 5.99% | 9.32% | 14.84% | 18.66% | 19.80% |
| Less than €20m | 6.51% | 6.45% | 6.96% | 10.13% | 15.45% | 18.20% | 19.24% |
| Total | 6.30% | 6.14% | 6.68% | 9.85% | 15.15% | 18.15% | 19.27% |
| No. CUs Reporting (Arrears) | 425 | 420 | 418 | 415 | 380 | 406 | 403 |

Notes: Data extracted from the Credit Union Annual Return for 2006 to 2010 (Audited).

All 2011 data is extracted from the Prudential Return (UNAUDITED).

For December 2011 one credit union has not submitted a return therefore the data is based on 403 credit unions.

3.6 Loans to assets ratios

¹¹ Between July 2010 and March 2011, the Central Bank undertook an inspection of 401 credit union loan books in order to establish the adequacy for provisions for bad and doubtful debts and to identify levels of additional provisions that need to be made by credit unions. The results indicate that 263 (or 66%) of credit unions did not have adequate provisions for bad and doubtful debts on their loan books and had a shortfall of €108m (or 28%) of their provisions.

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3.6.1 In Table 7 the loan to asset ratio is documented. On this count Irish credit unions appear to be significantly under-lent. During this period, the loan-to-asset ratio for the sector rose from 47.45% in 2006 to 52.11% in 2008. However, since 2008 this ratio has contracted quite quickly to 47.63% in 2009 and then to 40.76% in 2011. Part of the recent decline is due to the overall reduction in demand for personal loans. The loan-to-asset ratios of industrial credit unions are somewhat higher than those for community credit unions with the difference becoming quite pronounced in 2010 and 2011. Across the size bands, the average loan to asset ratio is broadly similar for the sector as a whole and for community credit unions but a much greater variability occurs for industrial credit unions.

Table 7 Loan to Assets Ratio – 2006 to 2011

| SECTOR | 31-Dec-2006 | 31-Dec-2007 | 31-Dec-2008 | 31-Dec-2009 | 31-Dec-2010 | 31-Dec-2011 |
|---------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Greater than €100m | 43.02% | 45.18% | 49.69% | 45.43% | 43.50% | 40.91% |
| €60m to €100m | 45.00% | 48.16% | 51.21% | 45.53% | 43.40% | 38.72% |
| €40m to €60m | 46.11% | 46.45% | 50.27% | 46.92% | 43.99% | 39.35% |
| €20m to €40m | 48.26% | 50.44% | 53.24% | 48.35% | 45.26% | 41.84% |
| Less than €20m | 48.37% | 49.89% | 52.52% | 48.13% | 44.57% | 40.92% |
| Average - Sector | 47.45% | 49.15% | 52.11% | 47.63% | 44.46% | 40.76% |
| COMMUNITY | | | | | | |
| Greater than €100m | 41.79% | 42.69% | 47.10% | 43.62% | 42.12% | 39.55% |
| €60m to €100m | 44.60% | 47.67% | 50.73% | 45.05% | 42.90% | 38.72% |
| €40m to €60m | 47.09% | 47.23% | 51.11% | 47.67% | 44.56% | 39.75% |
| €20m to €40m | 47.64% | 49.40% | 52.15% | 47.13% | 43.82% | 40.42% |
| Less than €20m | 48.31% | 49.76% | 51.96% | 47.54% | 43.52% | 39.76% |
| Average - Sector | 47.31% | 48.78% | 51.51% | 47.02% | 43.58% | 39.80% |
| INDUSTRIAL | | | | | | |
| Greater than €100m | 46.27% | 51.71% | 56.17% | 49.95% | 47.14% | 43.94% |
| €60m to €100m | 58.78% | 64.85% | 67.67% | 61.84% | 59.58% | 0.00% |
| €40m to €60m | 38.02% | 34.92% | 37.75% | 38.68% | 37.39% | 34.91% |
| €20m to €40m | 55.13% | 59.32% | 62.09% | 59.92% | 58.43% | 55.31% |
| Less than €20m | 48.75% | 50.65% | 55.91% | 51.86% | 51.85% | 49.55% |
| Average - Sector | 48.41% | 51.64% | 56.19% | 51.98% | 51.12% | 48.18% |

Note: Data is extracted from the Prudential Return for December each year (UNAUDITED)

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3.7 Dividends

3.7.1 In Table 8 the average dividend rate is detailed. There has been a pronounced decrease in the average rate of dividends paid to members since 2007. For the first two years of the period, average dividends to members were just over 2%. However, these fell to 1.94% in 2008, 1.58% in 2009, 0.90% in 2010 and to 0.58% in 2011. It is worth noting that there is an increasing gap between the average dividends of industrial credit unions and those of both community credit unions and the sector as a whole. In 2011, the average dividend paid by industrial credit unions was 0.89 percentage points greater than that for the sector as a whole and 0.96 percentage points greater than that paid by community credit unions.

Table 8 Average Dividends – 2006 to 2011

| | 30 Sept 2006 | 30 Sept 2007 | 30 Sept 2008 | 30 Sept 2009 | 30 Sept 2010 | 30 Sept 2011 |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Sector | | | | | | |
| Greater than €100m | 2.61 | 2.78 | 2.61 | 1.90 | 1.11 | 0.92% |
| €60m to €100m | 2.03 | 2.24 | 1.91 | 1.31 | 0.80 | 0.50% |
| €40m to €60m | 2.17 | 2.42 | 2.03 | 1.29 | 0.85 | 0.57% |
| €20m to €40m | 2.15 | 2.37 | 2.03 | 1.41 | 0.88 | 0.54% |
| Less than €20m | 2.09 | 2.22 | 1.81 | 1.71 | 0.91 | 0.56% |
| Total | 2.14 | 2.31 | 1.94 | 1.58 | 0.90 | 0.58% |
| Community | | | | | | |
| Greater than €100m | 2.60 | 2.80 | 2.51 | 1.84 | 1.03 | 0.76 |
| €60m to €100m | 2.01 | 2.22 | 1.88 | 1.26 | 0.75 | 0.50 |
| €40m to €60m | 2.13 | 2.41 | 2.00 | 1.20 | 0.80 | 0.51 |
| €20m to €40m | 2.14 | 2.32 | 1.99 | 1.39 | 0.78 | 0.49 |
| Less than €20m | 2.03 | 2.13 | 1.74 | 1.70 | 0.77 | 0.45 |
| Total | 2.10 | 2.25 | 1.88 | 1.54 | 0.79 | 0.49 |
| Industrial | | | | | | |
| Greater than €100m | 2.66 | 2.75 | 2.96 | 2.08 | 1.31 | 1.32 |
| €60m to €100m | 2.50 | 3.00 | 3.00 | 2.75 | 2.00 | - |
| €40m to €60m | 2.50 | 2.58 | 2.75 | 2.19 | 1.31 | 1.33 |
| €20m to €40m | 2.18 | 2.72 | 2.36 | 1.56 | 1.47 | 1.25 |
| Less than €20m | 2.45 | 2.71 | 2.27 | 1.79 | 1.64 | 1.60 |
| Total | 2.45 | 2.72 | 2.42 | 1.84 | 1.53 | 1.45 |
| Number of Credit Unions Reporting (I&E) | 425 | 420 | 418 | 415 | 392* | 318** |

Notes: All Data extracted from the Credit Union Annual Return for 2006 to 2010 (Audited);

* For 2010, the data excludes 17 Credit Unions who had not submitted an Annual Return;

**For 2011, the data excludes 86 Credit Unions who had not submitted an Annual Return.

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3.8 Liquidity

3.8.1 In Table 9 the liquidity ratio is documented. Despite the financial crisis and the challenges that it has posed, average liquidity has remained high and in December 2011 stood at 47.38%. Average liquidity is much higher for small credit unions (52% for credit unions with less than €20m in assets) compared to large credit unions (38.68% for credit unions with assets greater than €100m). There has also been a notable drop in the number of credit unions with liquidity of less than the regulatory requirement of 20%. In 2006, prior to the start of the financial crisis, 95 credit unions had liquidity of less than 20% but since then this number has decreased sharply to 43 in 2009 and to 5 in December 2011. Overall, it would appear that average liquidity is high.

Table 9 Liquidity – 2006 to 2011

| | 30 Sep 2006 | 30 Sep 2007 | 30 Sep 2008 | 30 Sep 2009 | 30 Sep 2010 | 30 Sep 2011 | 31 Dec 2011 |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Number with Liquidity < 20% | 95 | 90 | 108 | 43 | 20 | 7 | 5 |
| Greater than €100m | 8 | 10 | 8 | 2 | 1 | 1 | 0 |
| €60m to €100m | 9 | 5 | 13 | 1 | 1 | 1 | 0 |
| €40m to €60m | 15 | 13 | 14 | 5 | 2 | 0 | 0 |
| €20m to €40m | 24 | 21 | 23 | 8 | 8 | 1 | 0 |
| Less than €20m | 39 | 41 | 50 | 27 | 8 | 4 | 5 |
| Average Liquidity | 37.49% | 34.48% | 32.90% | 35.36% | 41.64% | 49.07% | 47.38% |
| Greater than €100m | 28.93% | 28.64% | 28.84% | 28.67% | 31.47% | 36.27% | 38.68% |
| €60m to €100m | 25.70% | 27.32% | 26.09% | 32.23% | 35.77% | 38.82% | 40.14% |
| €40m to €60m | 27.49% | 27.02% | 26.04% | 31.15% | 35.69% | 42.16% | 46.09% |
| €20m to €40m | 31.29% | 29.34% | 27.26% | 32.60% | 36.07% | 39.68% | 42.14% |
| Less than €20m | 44.78% | 39.92% | 38.00% | 38.71% | 47.58% | 57.63% | 52.00% |

Notes: All Data extracted from the Credit Union Annual Return for 2006 to 2010 (Audited);

2011 data is extracted from the Prudential Return (UNAUDITED)

One credit union reported liquidity of 263.3% for December 2011. This figure is correct but results from the fact that the credit union is dissolving. If this credit union were excluded from the calculation, the overall average would be 46.9% and the average for credit unions less than €20m would be 51%.

3.9 Reserves Profile

3.9.1 In Table 10 a profile is presented of realised reserves as a percentage of total assets. WOCCU's standard for institutional capital (undivided earnings and regular reserves only) is a minimum of 10% of total assets. Information is presented in terms of reserve to asset categories. As of December 2011, of the 403 credit unions analysed, 352 (87%) hold at least 10% of assets as total realised reserves¹². There are, however, 51 credit unions

¹² The Regulatory Reserve Ratio requires credit unions to hold a minimum of 10% assets in Total Regulatory Reserves. The Total Realised Reserve figure above includes any realised reserves that credit unions have reported in addition to the Total Regulatory Reserve. This includes the surplus / deficit that has been reported for the first nine months of the year. The information reported is unaudited and may be impacted by bad debt provisions and investment valuations which many credit unions make at year end.

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(13%) with total realised reserves below 10% of assets¹³ of which 25 credit unions could be considered to be significantly undercapitalised, having total realised reserves of less than 7.5% of assets. Since that date non-State stabilisation support has been agreed for some of these credit unions to address the position. These 25 credit unions have total realised reserves of €19.07m against total assets of €654.04m (or 2.9%). More generally, Table 10 highlights constancy, at least over the last four time periods, in the number of credit unions with total realised reserves of less than 10% of assets (an average of 56 credit unions over the period). This raises questions as to the financial soundness of these credit unions. Having said this, and noting that the March 2011, June 2011, September 2011 and December 2011 figures are extracted from unaudited Prudential Returns, it is pleasing to note that the reserve base for the sector as a whole has not been subject to a significant decline. However, it is important to note that credit unions are required to maintain a minimum level of reserves on an individual basis.

Table 10 Reserves – 2006 to 2011

| Average Reserves | 30 Sep 2006 | 30 Sep 2007 | 30 Sep 2008 | 30 Sep 2009 | 30 Sep 2010 | 31 Mar 2011 | 30 Jun 2011 | 30 Sep 2011 | 31 Dec 2011 |
|--------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Less than 7.5% | 47 | 24 | 15 | 19 | 8 | 22 | 24 | 29 | 25 |
| 7.5% to 8.0% | 19 | 10 | 5 | 4 | 5 | 2 | 3 | 1 | 1 |
| 8.0% to 8.5% | 34 | 15 | 7 | 5 | 5 | 8 | 3 | 2 | 1 |
| 8.5% to 9.0% | 33 | 19 | 18 | 7 | 8 | 9 | 7 | 9 | 5 |
| 9.0% to 9.5% | 34 | 37 | 28 | 12 | 14 | 8 | 7 | 5 | 12 |
| 9.5% to 10.0% | 51 | 28 | 37 | 13 | 14 | 14 | 12 | 6 | 7 |
| Greater than 10.0% | 207 | 287 | 308 | 355 | 338 | 346 | 352 | 354 | 352 |
| Total | 425 | 420 | 418 | 415 | 392 | 409 | 408 | 406 | 403 |

Notes: All Data extracted from the Credit Union Annual Return for 2006 to 2010 (Audited)

I&E: For 2010, the data excludes 17 CUs who had not submitted Annual Returns.

All 2011 data is extracted from the Prudential Return (UNAUDITED)

2006 - 2010 = Statutory Reserves + Realised Reserves - Dividend - Interest Rebate

2011 = Statutory Reserves + Additional Regulatory Reserves + Other Realised Reserves +/- Surplus/Deficit

For December 2011 one credit union has not submitted a return therefore the data is based on 403 credit unions.

3.9.2 As of December 2011, unaudited total assets were calculated at €13.784 billion and reserves at €1.84 billion with an average reserve ratio for the sector of 13%. The introduction of the Regulatory Reserve Ratio and close management of dividend payments by the Registry of Credit Unions together with the prudent approach to reserves by credit unions has helped to ensure that reserves have not been significantly depleted to date. However, earnings retained for reserves are not then available to pay dividends.

3.10 Return on Assets

¹³ The Regulatory Reserve Ratio, requiring credit unions to maintain a minimum of 10% of assets as total regulatory reserves, was introduced with effect from 30 September 2009. Transitional arrangements were provided for credit unions that could not meet the minimum Regulatory Reserve Ratio at that date. Such credit unions must achieve the Regulatory Reserve Ratio within the shortest timeframe possible, but not later than the timeframes and percentages set out below:

- 30 September 2011 – Regulatory Reserve Ratio of at least 8½ per cent;
- 30 September 2012 – Regulatory Reserve Ratio of at least 9 per cent;
- 30 September 2013 – Regulatory Reserve Ratio of at least 10 per cent.

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- 3.10.1 In Table 11 the average return on assets is documented for all credit unions. In the two years preceding the onset of the financial crisis, credit unions enjoyed a return on assets in excess of 3%, reaching 3.5% in 2007. Thereafter credit unions have suffered a sharp decline in their return on assets which by 2011 had fallen to 0.6%. Although not detailed in Table 11, 11% of credit unions reported a deficit in 2009, this increased to 17% in 2010 and to 21% in September 2011. The size distribution detailed in Table 11 suggests that credit unions with assets in excess of €100m are able to generate a higher return on assets than credit unions in the other size bands with this particularly so from 2008 onwards.

Table 11 Return on Assets – 2006 to 2011

| Sector | 30 Sept 2006 | 30 Sept 2007 | 30 Sept 2008 | 30 Sept 2009 | 30 Sept 2010 | 30 Sept 2011 |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Greater than €100m | 3.5% | 3.6% | 2.8% | 2.5% | 1.4% | 1.1% |
| €60m to €100m | 3.0% | 3.3% | 2.2% | 1.6% | 0.6% | 0.4% |
| €40m to €60m | 3.3% | 3.4% | 2.2% | 1.8% | 0.9% | 0.7% |
| €20m to €40m | 3.3% | 3.5% | 2.6% | 1.7% | 0.8% | 0.6% |
| Less than €20m | 3.3% | 3.6% | 2.4% | 1.4% | 1.0% | 0.6% |
| Total | 3.3% | 3.5% | 2.4% | 1.6% | 0.9% | 0.6% |
| No of Credit Unions Reporting (I&E) | 425 | 420 | 418 | 415 | 392* | 318** |

Notes: All Data extracted from the Credit Union Annual Return for 2006 to 2010 (Audited);

* For 2010, the data excludes 17 Credit Unions who had not submitted an Annual Return.

** For 2011, the data excludes 86 Credit Unions who had not submitted an Annual Return.

3.11 Financial Projections

- 3.11.1 In carrying out its work, the Commission benefited from a number of presentations that set out scenarios for the future capital adequacy of credit unions based on specific assumptions. These included the Strategic Review of the credit union sector conducted by Grant Thornton (projections made for 2011 to 2013) and the Prudential Capital Assessment Review (PCAR) undertaken by the Central Bank whereby baseline and adverse loan loss scenarios were applied to assumed financial forecasts (projections made for 2011 to 2013). These indicated a significant capital shortfall for the sector. The Commission, in carrying out its own work, notes that, as of December 2011, the position regarding arrears has increased to €1,021.22m, whilst bad debt provisions have increased to €800.78m. There are 25 credit unions with total realised reserves to asset ratios of less than 7.5% as of December 2011 and, as such, these credit unions can be considered to be seriously undercapitalised. Scenarios provided by Grant Thornton and the Central Bank project that, in the absence of corrective action by the Central Bank and the credit unions, the financial position of a significant number of credit unions will deteriorate markedly between now and 2013, due mainly to rising bad debts, poor governance and inadequate buffers of reserves. The Commission notes the continued deterioration in macro economic indicators. The Commission is of the view that, in addition to the level of loan losses and falling income currently being experienced by the sector, external

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factors, such as the introduction of personal insolvency legislation, could have a significant additional impact on the financial stability of the sector.

3.11.2 Summary

From the analysis the following points emerge:

- 3.12.1 Irish credit unions prior to the financial crisis and economic downturn (indeed for most of the last decade) have been under-lent. The average loan to asset ratio at 31 December 2011 was 40.76%, an historic low.
- 3.12.2 The share of investment holdings in Irish credit unions is high. This adversely impacts upon income generation as the return from investments tends to be lower than interest receivable on loans. This has been compounded by significant losses on investment portfolios accounted most notably in the 2008 and 2009 returns.
- 3.12.3 Adverse economic conditions are now translating into significantly higher levels of loan write-offs: 110% increase between 2008 and 2009, a further 22% increase between 2009 and 2010 and increases in arrears: As of 31 December 2011 there are 99 credit unions each with arrears over 25% of their gross loan books. Reassuringly, good practice and regulatory pressures have led to commensurately higher levels of bad debt provisioning. At 31 December 2011, about 80% of the arrears are provided for.
- 3.12.4 Since 2007 credit unions have suffered a sharp decline in their return on assets which by 2011 had fallen to 0.6% (with 21% of credit unions actually reporting a deficit in the 12 months to September 2011). This has led to a decrease in the average dividend rate (0.58% in 2011).
- 3.12.5 The adverse economic conditions have resulted in a decline in credit union performance and have made it difficult for credit unions to replenish reserves through retained earnings. As of 31 December 2011, 51 credit unions had total realised reserves less than 10% of assets and 25 credit unions could be considered seriously undercapitalised (less than 7.5%). And while it may not be the same credit unions that are undercapitalised in each time period there does appear to be constancy to date in the number identified as having total realised reserves of less than 10% of assets. That said, the average total realised reserves ratio for the sector has held up well and as of December 2011 was 13%.
- 3.12.6 Despite the financial crisis, average liquidity has remained high and currently stands at 47.38% (in 2011 only 5 credit unions failed in to meet the 20% regulatory requirement). This high level of average liquidity raises a problem in its own right as credit unions do not aggregate their liquid positions and in consequence do not avail of the higher returns which aggregation can generate. Excess liquidity appears to be more pronounced for smaller credit unions.
- 3.12.7 The financial profile reveals a commonality of the issues faced by credit unions of all sizes and common bond types. The declining fortunes of the Irish economy have not only put an additional brake on credit union development but arguably have contributed to regression in some credit unions. The strategic review of the sector carried out by Grant Thornton in January 2011 and the Central Bank's PCAR also envisage a further deterioration in credit union solvency. While the financial challenges now faced by

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credit unions are evident, they are not insurmountable but do reinforce a clear need to reform how credit unions are structured, governed and regulated.

Chapter 4 - Credit Union Survey Analysis

4.1 Introduction

- 4.1.1 This Chapter presents an overview of the findings of a survey of Irish credit unions. The objective of the survey was to inform the second phase of the Commission's work and this final Report of the Commission. The survey period commenced at the beginning of December 2011 and concluded at end January 2012. Credit unions were requested to have the survey undertaken by a person authorised to do so by the Board - the Chair, Secretary, Treasurer, other board member, Manager or other suitable officer of the credit union. It was asked that the completed survey return should represent the collective view of the board of directors.

4.2 Demographic profile of respondents

- 4.2.1 A total of 153 credit unions responded to the survey. This equates to a response rate of 38% (total number of credit unions 408). In Table 1 we profile the responding credit unions in terms of asset category. Three asset categories are analysed (i) greater than €60m, (ii) less than €60m but greater than €20m and (iii) less than €20m. We opted to divide the survey returns into only three size categories to ensure a sizeable number of returns in each. From Table 1 it is clear that a very high response rate was received from the asset category less than €60m but greater than €20m relative to the other size categories. Community credit unions make up 88.2% of the survey return with a broadly equal split between urban and rural credit unions.

Table 1 Profile of respondents

| Asset Categorisations | Total no. of Credit Unions | No. and (%) responding to survey | No. and (%) of respondents with community bond | No. and (%) of respondents with occupational bond | No. and (%) of respondents with 'other' bond | No. and (%) of respondents with rural membership |
|--------------------------------------|----------------------------|----------------------------------|--|---|--|--|
| Greater than €60m | 109 | 29 (26.6%) | 24 (82.8%) | 5 (17.2%) | 0 | 9 (31.1%) |
| Less than €60m but greater than €20m | 83 | 69 (83.1%) | 62 (89.9%) | 6 (8.7%) | 1 (1.4%) | 31 (44.9%) |
| Less than €20m | 216 | 54 (25%) | 48 (88.9%) | 3 (5.5%) | 1 (1.8%)* | 35 (64.8%) |
| Total | 408 | 153 (37.5%) | 135 (88.2%) | 14 (9.2%) | 2 (1.3%)* | 75 (49%) |

* Two credit unions did not respond to this question

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4.3 Change and Development

- 4.3.1 In Table 2 we present results of a relative ranking exercise where respondents were asked to rank pre-specified bodies (the management of the credit union, the board of directors, members, the trade association and the regulatory authorities) in order of their importance in driving the change process in the respondent's credit union. Our prior expectation would be that the board, as the members' representation and tasked with providing a strategic vision for the credit union, should in perception and actuality be viewed as instrumental in driving change within the credit union but that membership involvement in this process would also figure in a substantive way.

Table 2 Drivers of Change

| Please assess the relative importance of the following bodies in driving the change process in your credit union. Assess in order of importance 1 (NOT IMPORTANT) 2, 3, 4, 5 (EXTREMELY IMPORTANT) A: Management of the credit union; B: Board of Directors; C: Trade Association; D: Regulatory Authority; E Members | | | | | |
|---|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| | A | B | C | D | E |
| | % ranked 1 % ranked 1 or 2 | % ranked 1 % ranked 1 or 2 | % ranked 1 % ranked 1 or 2 | % ranked 1 % ranked 1 or 2 | % ranked 1 % ranked 1 or 2 |
| Asset Category | | | | | |
| Greater than €60m | 6.9% | 55.2% | 0 | 37.9% | 0 |
| | 58.6% | 89.6% | 0 | 51.7% | 0 |
| Less than €60m but greater than €20m | 17.4% | 52.2% | 0 | 18.8% | 11.6% |
| | 63.8% | 84.1% | 1.4% | 36.1% | 13% |
| Less than €20m | 18.5% | 53.7% | 0 | 14.8% | 13% |
| | 53.7% | 77.8% | 3.8% | 44.4% | 21.7% |
| All credit unions | 16.3% | 52.9% | 0 | 21.1% | 9.9% |
| | 59.5% | 83% | 2% | 42.1% | 13.2% |
| Common bond Type | | | | | |
| Community | 16.3% | 54.1% | 0 | 20.1% | 9.8% |
| | 60% | 82.2% | 2.3% | 42.5% | 12.8% |
| Occupational and Other | 12.5% | 43.8% | 0 | 31.3% | 12.5% |
| | 50% | 93.7% | 0 | 37.5% | 18.8% |

- 4.3.2 For ease of exposition, we present in Table 2 two pieces of information for each of the bodies considered (i) the percentage of respondents which ranked the body in question 1st in importance in driving change and (ii) the percentage who ranked it 1st or 2nd in importance in driving change. The analysis is presented by size class and common bond type. If we focus our discussion on the primary driver (ranked 1st), it is the board of directors across all categories that is identified as the key agent of change followed surprisingly in each category (with the exception of credit unions with assets less than €20m) by the regulatory authorities. Management is second most important for credit

unions with assets of less than €20m but third in importance for the other categories. Interestingly, members appear not to be key drivers of change. These findings are at odds with a recent study by Goth, McKillop and Wilson (2012) which analysed centrally affiliated and federated Canadian credit unions and US credit unions. They found that the key driver of change was management followed by the board of directors potentially suggesting a principal-agent problem. Members, as in Irish credit unions, were third in importance but unlike Ireland the regulatory bodies in the US and Canada had little influence in driving change at the level of the individual credit union.

4.4 Internal Constraints on Credit Union Development

- 4.4.1 Respondents were provided with a list of 12 possible internal constraints to the development of their credit union (see Table 3). Respondents assessed each constraint on a scale of 1 (not important) to 5 (extremely important). For ease of exposition, we present an average score for each of the constraints and focus the discussion on those constraints that received a score of over 4 which suggests that, as a constraint on development, they are located somewhere between important and extremely important.
- 4.4.2 Attracting volunteers with key skills is of paramount importance to all categories analysed; indeed this appears to be the area which credit unions view as the most serious internal constraint on development. It is also the case that as credit union size decreases attracting volunteers with key skills becomes more of an issue. Training of staff and volunteers is also of pronounced importance to all categories but in this case it is more of an issue for larger credit unions. This may reflect the fact that size equates with sophistication, placing greater requirements on staff and volunteers. A similar pattern also pertains to technology used for service delivery. It is considered to be a very important constraint; but much more so for larger credit unions, suggesting that they are increasingly dependent on technology for both processing and service delivery. Attracting and retaining young members is important to all categories but particularly so for occupational credit unions. This may centre on the constraint placed on them by definition of their common bond (Table 3 also highlights that common bond is more of an issue for occupational credit unions than for the other categories). The credit union image is also viewed as an internal constraint on development and considered to be more so for larger credit unions. This may suggest that respondents considered that work is required to ensure that the credit union image remains current going forward. (Table 3 also highlights marketing as more problematic for larger credit unions than for the other categories.) Finally, leadership within the credit union was considered an important internal constraint. This is perhaps no surprise when it is set in the context of this analysis which highlights there to be a view that many and varied factors are currently constraining the development of credit unions.

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Table 3 Internal Constraints on Development

| Potential constraints | Greater than €60m | Less than €60m but greater than €20m | Less than €20m | All credit unions | Community | Occupational and other |
|--|-------------------|--------------------------------------|----------------|-------------------|---------------|------------------------|
| | Average Score | Average Score | Average Score | Average Score | Average Score | Average Score |
| Age profile of members | 3.21 | 3.43 | 3.13 | 3.26 | 3.39 | 3.75 |
| Attracting and retaining young members | 4.03 | 4.26 | 4.22 | 4.19 | 4.18 | 4.38 |
| Attracting volunteers with key skills | 4 | 4.36 | 4.41 | 4.31 | 4.33 | 4.25 |
| Common bond | 3.41 | 3.03 | 3.26 | 3.2 | 3.16 | 3.56 |
| Credit union image | 4.21 | 4.12 | 4 | 4.1 | 4.14 | 3.81 |
| Credit union size | 3.34 | 3.06 | 3.37 | 3.21 | 3.17 | 3.63 |
| Leadership within your credit union | 4.21 | 4.23 | 3.79 | 4.05 | 4.02 | 4.38 |
| Limited product and service offering | 3.69 | 3.75 | 3.51 | 3.64 | 3.71 | 3.25 |
| Marketing | 4 | 3.93 | 3.42 | 3.75 | 3.79 | 3.5 |
| Technology used for service delivery | 4.45 | 4.43 | 3.77 | 4.21 | 4.19 | 4.44 |
| Training of staff and volunteers | 4.29 | 4.25 | 4.01 | 4.18 | 4.15 | 4.13 |
| Quality of premises | 3.11 | 3.59 | 3.42 | 3.44 | 3.5 | 3.06 |

1 if the factor is not important; 2 if the factor is a little important; 3 if the factor is moderately important; 4 if the factor is quite important; and 5 if the factor is extremely important.

4.5 External Constraints on Credit Union Development

- 4.5.1 Respondents were also asked to consider six external factors which may be a constraint on the development of their credit union (Information is presented in Table 4). Not surprisingly, the ongoing adverse economic conditions loomed large as an external constraint on development. A similar pattern of average scores were ascribed to both the regulatory authority and the regulatory framework. Each were considered as considerable external constraints on development and perceived to be more so by larger credit unions. Leadership at movement level was also identified as an important constraint on development with this viewed to be particularly so for community credit unions and for those credit unions with assets of less than €20m. Again setting this in

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the context of the plethora of internal and external challenges viewed by credit unions as constraining development, it is no surprise that they want much more from the leadership at movement level.

- 4.5.2 While still of importance, with average scores of three and above, credit unions considered competition from other financial providers and the limited provision of centralised services to be lesser external constraints on development than those previously considered.

Table 4 External Constraints on Development

| Potential constraints | Greater than €60m | Less than €60m but greater than €20m | Less than €20m | All credit unions | Community | Occupational and other |
|--|-------------------|--------------------------------------|----------------|-------------------|---------------|------------------------|
| | Average Score | Average Score | Average Score | Average Score | Average Score | Average Score |
| Competition from other financial providers | 3.55 | 3.19 | 3.13 | 3.26 | 3.25 | 3.56 |
| Economic conditions | 4.89 | 4.64 | 4.7 | 4.72 | 4.72 | 4.63 |
| Leadership at movement level | 3.93 | 4.06 | 4.28 | 4.12 | 4.21 | 3.31 |
| Limited provision of centralised services | 3.32 | 3.68 | 3.47 | 3.55 | 3.62 | 2.94 |
| Regulatory Authority | 4.52 | 4.28 | 4.09 | 4.23 | 4.23 | 4.25 |
| Regulatory Framework | 4.5 | 4.3 | 4.02 | 4.23 | 4.2 | 4.38 |

1 if the factor is not important; 2 if the factor is a little important; 3 if the factor is moderately important; 4 if the factor is quite important; and 5 if the factor is extremely important.

4.6 Income and Expenditure

- 4.6.1 We have profiled how respondents believe income (Table 5) of the credit union is expected to change over the course of the next three years. With regard to income projections the dominant response is that credit unions expect income to decrease by more than 5%. This finding is most prevalent for larger credit unions with 58.6% of credit unions with assets in excess of €60m expecting income to fall by more than 5%. This finding is also more prevalent for community based credit unions (48.9%), compared to occupational credit unions (37.5%). Overall 28.8% of credit unions expect income to remain static; 47.7% expect it to fall by more than 5%; and 23.5% expect it to increase by more than 5%.

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Table 5 - Income projections over next 3 years

| | Decrease by 5% or more | % | Remain static | % | Increase by 5% or more | % | Mean |
|---|------------------------------|-------|------------------|-------|------------------------------|-------|------|
| Asset Category | | | | | | | |
| Greater than €60m | 17 | 58.6% | 7 | 24.2% | 5 | 17.2% | 1.59 |
| Less than €60m but greater than €20m | 33 | 47.8% | 21 | 30.4% | 15 | 21.8% | 1.74 |
| Less than €20m | 23 | 42.6% | 16 | 29.6% | 15 | 27.8% | 1.85 |
| All credit unions | 73 | 47.7% | 44 | 28.8% | 36 | 23.5% | 1.76 |
| Common Bond Type | | | | | | | |
| Community | 66 | 48.9% | 38 | 28.1% | 31 | 23.0% | 1.74 |
| Occupational and other | 6 | 37.5% | 5 | 31.2% | 5 | 31.3% | 1.94 |

Note: The total responses to this question in terms of asset size and common bond may at times differ given that some credit unions failed to identify their asset size and/or bond type.

- 4.6.2 In Table 6 expenditure projections for the next three years are detailed. The most common response was that expenditure is expected to remain static over the next three years. This finding is most prevalent for credit unions with assets in excess of €60m (62.1%) and for occupational credit unions (81.3%). Overall 51.7% of credit unions expect expenditure to remain static; 25.1% expect it to fall by more than 5%; and 23.2% expect it to increase by more than 5%.
- 4.6.3 These findings suggest that for a majority of credit unions their business model is likely to come under increasing pressure over the course of the next three years with an expected decline in the income base and static expenditure. The situation is particularly stark when set in the context of the Commission's earlier reviews of trends in income and expenditure over the period 2006 to 2010 (see Chapter 3). Between 2006 and 2010, credit union costs almost doubled, from €321.51m to €626.77m resulting in a pronounced increase in the cost to income ratio, which overall was 49.5% in 2006 but by 2010 had risen to 83.3% (subsequently increasing to 87.2% in 2011). Previously, we noted that the income of credit unions has varied from year to year; it peaked in 2007 at €860.4m prior to the onset of the financial crisis and in 2010 stood at €772.42m. The principle component of credit union income is interest income between 2006 and 2009, income from interest payments increased from €572.88m to €613.52m (an increase of 7%) before falling sharply in 2010 to €546.47m (a decrease of 11%). This downward fall between 2009 and 2010 is of such a magnitude that it takes interest income to a level lower than what it was in 2006.

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Table 6 - Expenditure projections over next 3 years

| | Decrease by 5% or more | % | Remain static | % | Increase by 5% or more | % | Mean |
|---|---------------------------|--------------|------------------|--------------|------------------------------|--------------|-------------|
| Asset Category | | | | | | | |
| Greater than €60m | 7 | 24.1% | 18 | 62.1% | 4 | 13.8% | 1.90 |
| Less than €60m but greater than €20m | 20 | 29.4% | 35 | 51.5% | 13 | 19.1% | 1.90 |
| Less than €20m | 11 | 20.7% | 25 | 47.2% | 17 | 32.1% | 2.11 |
| All credit unions | 38 | 25.1% | 78 | 51.7% | 35 | 23.2% | 1.98 |
| Common Bond Type | | | | | | | |
| Community | 35 | 26.3% | 65 | 48.9% | 32 | 24.8% | 1.98 |
| Occupational and other | 1 | 6.2% | 13 | 81.3% | 2 | 12.5% | 2.06 |

Note: The total responses to this question in terms of asset size and common bond may at times differ given that some credit unions failed to identify their asset size and/or bond type.

4.7 Products and Services

- 4.7.1 First we consider what the board of directors considers to be the primary function of the credit union in terms of member service provision now and in five years time. Respondents were asked to nominate one of four patterns (1 the board of directors views the credit union's primary function as that of a financial institution providing its members with a full range of financial services in direct competition with other financial institutions; 2 the board of directors views the credit union's primary function as that of a financial co-operative providing its members with as full a range of financial services as possible; 3 the board of directors views the credit union's primary function as that of a financial co-operative providing its members with a narrow range of savings and loans products; 4 the board of directors views the credit union's primary function as providing credit services for financially excluded individuals who would otherwise be unable to access credit).
- 4.7.2 The first point to note is that currently and for the future no credit union considers its **primary** function as providing credit services for financially excluded individuals who would otherwise be unable to access credit. Furthermore, only a limited number of credit unions see their **primary** function as that of a financial institution providing its members with a full range of financial services in direct competition with other financial institutions, (currently 1.5% increasing to 10.4% in five years time). Credit unions currently and increasingly in the future identify themselves with pattern 2, that is, as financial co-operatives providing their members with as full a range of financial services as possible. From Table 7 we can see that pattern 2 is identified for 65.7% of credit unions with the expectation that this will rise to 77.8% in five years time. Most displacement occurs around pattern 3 with currently 32.1% of credit unions viewing themselves as a financial co-operative providing its members with a narrow range of savings and loans products. This is expected to fall to 9.6% in five years time.

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Table 7 Product and Service Development

| | Which pattern comes close to the way things currently operate at your credit union? | | | | In five years time which of the patterns is likely to best reflect how your board might be expected to view your credit union? | | | |
|---|--|-------------------|-------------------|-----------------|---|--------------------|------------------|-----------------|
| | Pattern 1 | Pattern 2 | Pattern 3 | Pattern 4 | Pattern 1 | Pattern 2 | Pattern 3 | Pattern 4 |
| Asset Category | | | | | | | | |
| Greater than €60m | 2 (6.9%) | 24 (82.8%) | 3 (10.3%) | 0 (0.0%) | 5 (17.2%) | 24 (82.8%) | 0 (0.0%) | 0 (0.0%) |
| Less than €60m but greater than €20m | 3 (4.3%) | 48 (69.6%) | 18 (26.1%) | 0 (0.0%) | 6 (8.7%) | 58 (84.1%) | 5 (7.2%) | 0 (0.0%) |
| Less than €20m | 0 (0.0%) | 22 (41.5%) | 30 (56.6%) | 1 (1.9%) | 6 (11.1%) | 32 (59.3%) | 13 (24.1%) | 3 (5.6%) |
| All credit unions | 2 (1.5%) | 88 (65.7%) | 43 (32.1%) | 1 (0.7%) | 14 (10.4%) | 105 (77.8%) | 13 (9.6%) | 3 (2.2%) |
| Common bond Type | | | | | | | | |
| Community | 5 (3.3%) | 94 (61.8%) | 52 (34.2%) | 1 (0.7%) | 17 (11.1%) | 114 (74.5%) | 19 (12.4%) | 3 (2%) |
| Occupational and other | 3 (18.8%) | 5 (31.2%) | 8 (50%) | 0 (0.0%) | 3 (18.8%) | 5 (31.2%) | 5 (50%) | 0 (0.0%) |

1 the board of directors views the credit union's primary function as that of a financial institution providing its members with a full range of financial services in direct competition with other financial institutions; 2 the board of directors views the credit union's primary function as that of a financial co-operative providing its members with as full a range of financial services as possible; 3 the board of directors views the credit union's primary function as that of a financial co-operative providing its members with a narrow range of savings and loans products; 4 the board of directors views the credit union's primary function as providing credit services for financially excluded individuals who would otherwise be unable to access credit.

Note: The total responses to this question in terms of asset size and common bond may at times differ given that some credit unions failed to identify their asset size and/or bond type.

- 4.7.3 The questionnaire asked that respondents identify, to a maximum of four, new products and services which it is now important that the credit union provides to members. The question was open-ended in that respondents were not asked to choose from a prescribed range of products and services. This information is collated in Table 8 by asset category. Five product/service lines prove to be important to a substantive number of credit unions – debit/laser cards 62 (40.5%) of credit unions; online banking/online services 56 (36.6%) of credit unions; EFT 45 (29.4%) of credit unions; ATMs 33 (21.6%) of credit unions; and insurance products and services 26 (17.0%). Many of these services, for example EFT, are already on offer by some credit unions but it is clear that there exists a latent demand by many others to enhance their existing product and service range. For larger credit unions (assets greater than €60m) technology based services (debit/laser cards and online banking/online services) are the key product demands. For credit unions with assets between €20m and €60m the new product requirements are online banking/online services, debit/laser cards and EFT, while for those with assets less than €20m it is online banking/online services, ATMs and EFT.

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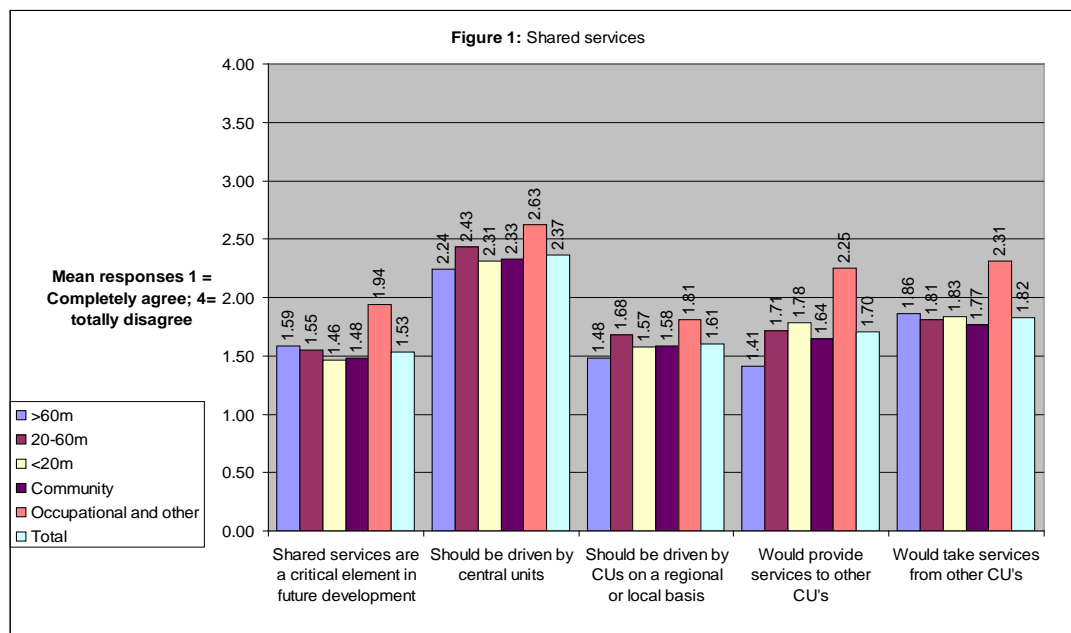
Table 8 Products and services

| Product or Service | Greater than €60m | Less than €60m but greater than €20m | Less than €20m | All credit unions |
|---|-----------------------------|--------------------------------------|-------------------------|-------------------------|
| | Number (%) of credit unions | Number of credit unions | Number of credit unions | Number of credit unions |
| Current accounts | 2 (6.9%) | 4 (5.8%) | 3 (5.6%) | 9 (5.9%) |
| Debit/laser cards | 21 (72.4%) | 30 (43.5%) | 11 (20.4%) | 62 (40.5%) |
| Credit cards | 5 (17.2%) | 3 (4.3%) | 0 (0.0%) | 8 (5.2%) |
| ATMs | 7 (24.1%) | 11 (15.9%) | 15 (27.8%) | 33 (21.6%) |
| Online banking/ Online services | 14 (48.3%) | 25 (36.2%) | 17 (31.5%) | 56 (36.6%) |
| E Statement/AGM booklet | 2 (6.9%) | 0 (0.0%) | 0 (0.0%) | 2 (1.3%) |
| EFT | 6 (20.7%) | 26 (37.7%) | 13 (24.1%) | 45 (29.4%) |
| Payroll deductions from wages | 3 (10.3%) | 0 (0.0%) | 2 (3.7%) | 5 (3.3%) |
| Paypath | 4 (13.8%) | 0 (0.0%) | 2 (3.7%) | 4 (2.6%) |
| Bill pay | 0 (0.0%) | 5 (7.2%) | 8 (14.8%) | 13 (8.5%) |
| Budget accounts | 1 (3.4%) | 6 (8.7%) | 1 (1.9%) | 8 (5.2%) |
| Direct debit | 1 (3.4%) | 5 (7.2%) | 3 (5.6%) | 9 (5.9%) |
| Mortgages | 1 (3.4%) | 0 (0.0%) | 1 (1.9%) | 2 (1.3%) |
| Commercial lending | 1 (3.4%) | 3 (4.3%) | 0 (0.0%) | 4 (2.6%) |
| Other lending | 3 (10.3%) | 10 (14.4%) | 1 (1.4%) | 14 (9.2%) |
| Financial/budgeting advice | 4 (13.8%) | 12 (17.4%) | 2 (3.7%) | 18 (11.8%) |
| Basic payment account/Financial inclusion | 1 (3.4%) | 2 (2.9%) | 0 (0.0%) | 3 (2.0%) |
| Foreign exchange | 0 (0.0%) | 3 (4.3%) | 4 (7.4%) | 7 (4.6%) |
| Direct government/Social welfare payments | 1 (3.4%) | 4 (5.8%) | 4 (7.4%) | 9 (5.9%) |
| Paypath | 2 (6.9%) | 0 (0.0%) | 2 (3.7%) | 4 (2.6%) |
| Insurance products/services | 6 (20.7%) | 13 (18.8%) | 7 (13.0%) | 26 (17.0%) |
| CUSOs | 2 (6.9%) | 2 (2.9%) | 1 (1.4%) | 5 (3.3%) |
| Nationwide accessibility to funds | 0 (0.0%) | 1 (1.4%) | 4 (7.4%) | 5 (3.3%) |
| Shared lodgement/withdrawal service | 0 (0.0%) | 2 (2.9%) | 0 (0.0%) | 2 (1.3%) |
| Revolving credit facility | 0 (0.0%) | 2 (2.9%) | 1 (1.4%) | 3 (2.0%) |
| Marketing/social media | 0 (0.0%) | 1 (1.4%) | 1 (1.4%) | 2 (1.3%) |
| PRSAs | 0 (0.0%) | 2 (2.9%) | 0 (0.0%) | 2 (1.3%) |

4.8 Shared Services

- 4.8.1 One element of better managing expenditure may be in the form of shared service arrangements. Initially the survey asked respondents to assess the extent to which they agreed with each of five statements. These statements are detailed in Figure 1. For ease of exposition, an average score based on an allocation of 1 (completely agree), 2 (somewhat agree), 3 (somewhat disagree) and 4 (totally disagree) is calculated for the respective groups.

Figure 1 Shared Services



- 4.8.2 From Figure 1 it can be seen that respondents strongly agree with the statement that shared services are a critical element in the future development of their credit union. This is the case for credit unions of all size categories and viewed as more important the smaller the size of the credit union. Shared services are also considered to be more important in the development of community credit unions than occupational credit unions, although still of considerable importance to the latter.
- 4.8.3 Two questions were asked as to who should provide shared service - Should shared services be driven by a central unit or units? Should shared services be driven by credit unions on a regional or local basis? From the responses detailed in Figure 1, it would appear that more support is forthcoming for the provision of services on a local or regional basis. The average score for all credit unions was 2.37 for providing services by a central unit(s) compared to 1.61 for providing services on a regional or local basis.
- 4.8.4 Survey respondents were asked whether their credit union would provide services to other credit unions and also whether their credit union would take services from other credit unions. From Figure 1 it is evident that there is an appetite among credit unions to both provide services to others and to take services from others (with the exception of occupational credit unions, all credit union categories have an average score of less than 2). Having made the point that there is a willingness to provide and receive services, it is also evident from Figure 1 that in each of the categories credit unions are more willing to act as provider than a receiver.
- 4.8.5 The questionnaire next detailed 15 different functions/services that could potentially be amenable to being provided on a shared service basis. Respondents were then asked to identify for each function how important they considered sharing to be on the basis of 1 (sharing the service is not important); 2 (sharing the service is a little important); 3 (sharing the service is moderately important); 4 (sharing the service is quite important) and 5 (sharing the service is extremely important). For each function/service an average score is calculated and presented in Table 9. For convenience let the focus be on

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functions/services which achieve an average score greater than 4 which suggests that the importance attached to sharing lies somewhere between quite important and extremely important.

Table 9 - Shared Services

| Shared Services | Greater than €60m | Less than €60m but greater than €20m | Less than €20m | All credit unions | Community | Occupational and other |
|---------------------------------------|-------------------|--------------------------------------|----------------|-------------------|---------------|------------------------|
| | Average Score | Average Score | Average Score | Average Score | Average Score | Average Score |
| Compliance | 4.03 | 4.13 | 4.11 | 4.10 | 4.18 | 3.69 |
| Debt collection | 3.62 | 4.06 | 4.33 | 4.07 | 4.10 | 3.81 |
| Attracting volunteers with key skills | 3.17 | 3.61 | 3.96 | 3.65 | 3.70 | 3.31 |
| Development of best practices | 4.45 | 4.29 | 4.46 | 4.39 | 4.42 | 4.06 |
| HR | 3.69 | 3.71 | 3.72 | 3.72 | 3.76 | 3.50 |
| Investment advice | 3.79 | 3.84 | 4.22 | 3.96 | 3.96 | 3.94 |
| Investment services | 3.55 | 3.56 | 3.83 | 3.65 | 3.66 | 3.50 |
| Internal audit function | 3.97 | 4.16 | 4.06 | 4.08 | 4.17 | 3.63 |
| IT system | 4.21 | 4.09 | 3.98 | 4.09 | 4.12 | 3.88 |
| Marketing and branding | 4.21 | 4.25 | 4.15 | 4.21 | 4.29 | 3.38 |
| Merger/takeover processing | 3.82 | 2.88 | 2.67 | 2.97 | 2.92 | 3.50 |
| Revised insurance products | 3.54 | 3.11 | 3.15 | 3.20 | 3.23 | 2.94 |
| Risk management function | 4.18 | 4.29 | 4.23 | 4.25 | 4.33 | 3.75 |
| Social media | 3.86 | 3.67 | 3.47 | 3.61 | 3.70 | 3.00 |
| Specialised lending | 3.50 | 3.36 | 2.74 | 3.16 | 3.17 | 3.25 |

- 4.8.6 For all six credit union categorisations there is a strong demand for sharing the development of best practices which may well be driven by the uncertain environment that credit unions now find themselves in. Compliance, risk management and marketing and branding each have an average score in excess of 4 for five of the six credit union categories (in each case occupational credit unions scored these functions/services less than 4). Debt collection, internal audit function and IT systems each have an average score in excess of 4 for four of the six credit union categories. Thereafter, only investment advice was identified by a score of greater than 4 and in this case by only one credit union categorisation (credit unions with assets less than €20m).

4.9 Information Technology

- 4.9.1 Information technology (IT) has altered the ways in which consumers access services, mainly through automated distribution channels such as the internet, phone-based and

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other banking access channels. It is also true that, for the financial service provider, IT can yield cost savings in the management of information (collection, storage, processing and transmission), and through substituting paper-based and labour-intensive procedures with automated processes. Given this context, it should therefore be of no surprise to learn that credit unions at an individual level have pursued their own IT development programmes with various levels of sophistication and degrees of success.

- 4.9.2 In Table 10 we present survey responses around a number of issues. In the first instance, we report on whether credit unions are satisfied with their IT provider. Overall 87.4% of credit unions are satisfied with their IT provider. There is little difference in satisfaction levels between community and occupational credit unions but some evidence that as credit union size declines there is an increase in satisfaction with the credit union's IT provider (79.3% of credit unions with assets greater than €60m are satisfied with their IT provider compared with 94.3% for those with assets less than €20m).
- 4.9.3 Respondents were asked which of three statements best describes their credit union's IT requirements over the next three years - our IT systems are appropriate to meet our future needs; with some investment our IT systems will meet our future needs; we will have to make significant investment in IT to meet future needs. As might be expected the most common response was 'with some investment our IT systems will meet our future needs'. Overall 61.4% of credit unions identified this as their choice. From Table 10 it also emerges that this becomes more common a response as credit unions increase in size (86.2% for credit unions with assets greater than €60m compared to 44.4% for those with assets less than €20m). Similarly, with respect to management business information needs, credit unions were asked over the next three years which of the following statements best describes your management business information knowledge requirements - our IT knowledge and skills are appropriate to meet future needs; with some investment our IT knowledge and skills will meet future needs; we will have to make significant investment in our IT knowledge and skills to meet future needs. Overall 71.1% believed that 'with some investment our IT knowledge and skills will meet future needs'. Very few respondents considered that there was a need for significant investment in their IT knowledge and skills and only in the case of credit unions with assets of less than €20m was there a substantive number (28.3%) of the opinion that IT knowledge and skills were appropriate to meet future needs.

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Table 10 IT Provision and Capabilities

| Asset Category | Satisfied with IT provider? | | IT requirements for future needs | | | Management Business Information needs | | |
|--------------------------------------|-----------------------------|----------------|----------------------------------|------------------------|-------------------------------|---------------------------------------|------------------------|-------------------------------|
| | | | Appropriate | Some investment needed | Significant investment needed | Appropriate | Some investment needed | Significant investment needed |
| Greater than €60m | Yes | 23 (79.3%) | 1 (3.5%) | 22 (86.2%) | 3 (10.3%) | 4 (13.8%) | 23 (79.3%) | 2 (6.9%) |
| Less than €60m but greater than €20m | Yes | 58 (84.1%) | 12 (17.4%) | 44 (63.8%) | 13 (18.8%) | 10 (14.5%) | 53 (76.8%) | 6 (8.7%) |
| Less than €20m | Yes | 50 (94.3%) | 21 (38.9%) | 24 (44.4%) | 9 (16.7%) | 15 (28.3%) | 32 (60.4%) | 6 (11.3%) |
| All credit unions | Yes | 132 (87.4%) | 34 (22.2%) | 94 (61.4%) | 25 (16.3%) | 29 (19.1%) | 108 (71.1%) | 15 (9.9%) |
| Common Bond Type | | | | | | | | |
| Community | Yes | 117 (87.3%) | 29 (21.5%) | 83 (61.5%) | 23 (17%) | 26 (19.4%) | 94 (70.1%) | 14 (10.4%) |
| Occupational and other | Yes | 13 (86.7%) | 3 (18.8%) | 11 (68.8%) | 2 (12.5%) | 3 (18.8%) | 12 (75%) | 1 (6.3%) |

Note: Some rows and columns do not balance due to some respondents not completing all IT questions

4.10 Transfers and amalgamations / mergers

- 4.10.1 In Ireland, amalgamation activity amongst credit unions has been almost non-existent. However, as the movement, over the coming years, moves towards maturity, amalgamations are likely to become common. The motives for credit union amalgamations articulated for movements elsewhere include: the drive for greater operational economies of scale and scope; a need to broaden the common bond; a demand for wider distribution networks; the need to eliminate financially weak credit unions to ensure efficiency and stability within the sector; the creation of critical mass to permit credit unions to become major players in today's technology-driven business; and the need to create critical mass to enable a broader portfolio of products and services to be provided to members within a professionally managed operating environment.^{ix}
- 4.10.2 In Figure 2 and in Table 11, responses to three questions are profiled. First, would your credit union consider absorbing another credit union? Second, would your credit union consider being absorbed by another credit union? Third, would your credit union consider merging with another credit union? From the material detailed, it is clear that there is only a limited appetite among credit unions for being absorbed into another credit union. This very much contrasts with the willingness by credit unions to absorb others. While overall 64.1% of credit unions indicate they would absorb another credit union there is a pronounced difference between small and large credit unions (96.6% of credit unions with assets greater than €60m would absorb another credit union but this falls to 37.0% for those with assets less than €20m).
- 4.10.3 Mergers, which represent a more equal coming together, are also relatively positively received by a majority of credit unions. Overall 59.5% of credit unions indicate they would consider merging with another credit union. Again there appears to be a size effect with larger credit unions more accepting of this option (75.9% of credit unions

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with assets greater than €60m would merge with another credit union with this falling to 44.4% for those with assets less than €20m).

Figure 2 Transfers and amalgamations / mergers

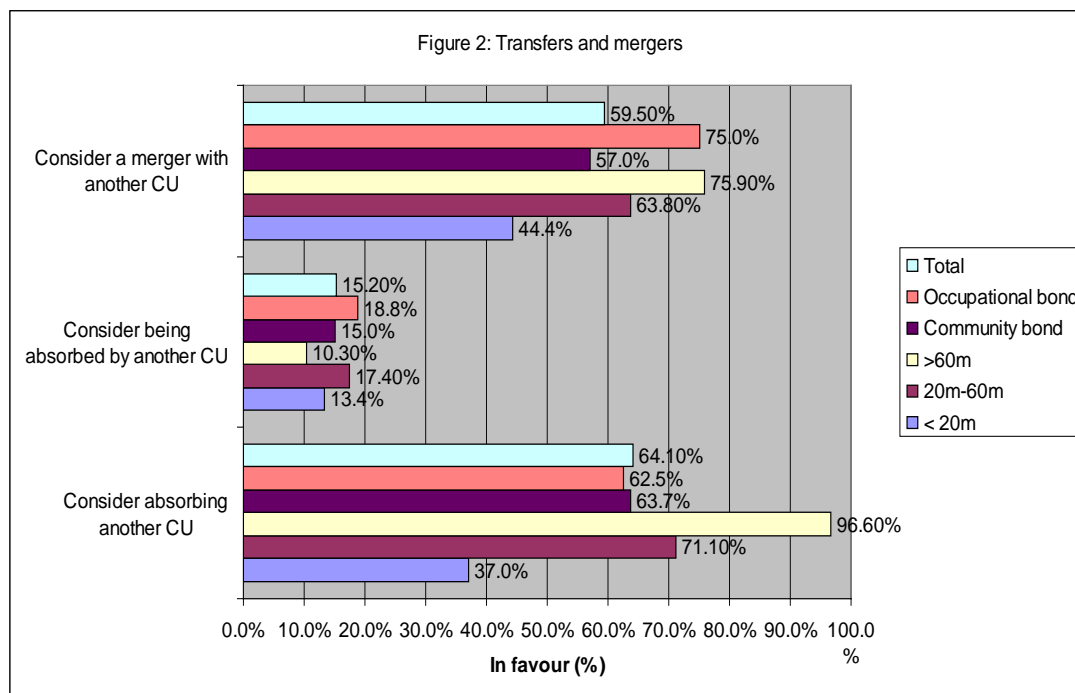


Table 11 Transfers and amalgamations / mergers

| Transfers and amalgamations / mergers | No. and (%) that would consider absorbing another credit union | | No. and (%) that would consider being absorbed by another credit union | | No. and (%) that would consider merging with another credit union | |
|---------------------------------------|--|---------------|--|---------------|---|---------------|
| | No. | % | No. | % | No. | % |
| Asset Category | | | | | | |
| Greater than €60m | 28 | 96.60% | 3 | 10.3% | 22 | 75.90% |
| Less than €60m but greater than €20m | 49 | 71.10% | 12 | 17.40% | 44 | 63.80% |
| Less than €20m | 20 | 37.0% | 7 | 13.4% | 24 | 44.4% |
| All credit unions | 98 | 64.10% | 23 | 15.20% | 91 | 59.50% |
| Common bond Type | | | | | | |
| Community | 86 | 63.7% | 20 | 15.0% | 77 | 57.0% |
| Occupational and other | 10 | 62.5% | 3 | 18.8% | 12 | 75.0% |

Note: The total responses to this question in terms of asset size and common bond may at times differ given that some credit unions failed to identify their asset size and/or bond type.

4.11 Common bond

- 4.11.1 Credit unions cannot do business with the general public due to charter limitations based on serving a membership that is characterised by a common bond. The common bond definition is the subject of legal regulation and confers on credit unions a key defining characteristic. The common bond restriction on membership is assumed to reduce the cost of gathering credit information, thereby minimising the exposure of individual credit unions to bad debt losses. The existence of a common bond, as the organisational basis of credit unions, has been seen by many commentators as a strength; equally it has been seen as an Achilles' heel. Those that perceive it as a weakness argue that a narrowly defined common bond limits credit union growth because it restricts the pool of members to a finite group and so reduces the ability of the credit union to avail of scale and scope economies and also reduces its ability to diversify geographic and concentration risk.
- 4.11.2 Actual definitions of a common bond, and whether this is tightly or loosely defined, depends to a large extent on the nature of social, political, and economic environments, and also, crucially, on the particular legislation governing the operation of credit unions. The main types of common bond are community, occupational and associational. Most common bonds in Ireland are relatively tightly defined and are community-based. This contrasts with the situation in many other countries (Canada, Australia, US and UK) where the common bond tends to be much more loosely defined.
- 4.11.3 In Figure 3 and in Table 12 the response to three statements are profiled - the membership should continue to come from one common bond; the membership should come from several common bonds; the membership should be open to anyone who wants to join. Overall 53.6% of credit unions consider that the membership should continue as currently constituted. There is somewhat of a difference in view between large and small credit unions (35.7% of credit unions with assets greater than €60m believe the membership should continue to come from one common bond compared to 55.6% for those with assets less than €20m). Similarly there was a difference in view between credit unions subject to different common bond types (54.9% of community credit unions believe the membership should continue to come from one common bond compared to 37.5% of occupational credit unions). Interestingly, there were a number of respondents, (26.5%) for the sector as a whole, who considered that credit unions should be open to all, implying no role for the common bond. In this instance, there was no systematic size effect.

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Figure 3 Common Bond

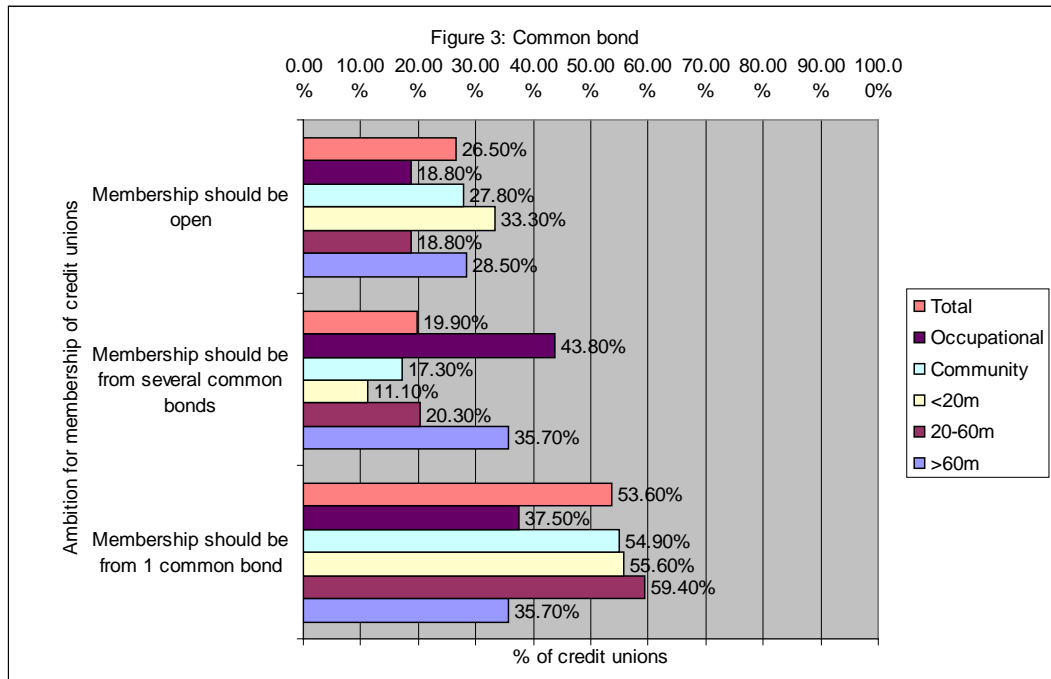


Table 12 Common bond

| Common bond | No. and (%) that would consider that the membership should continue to come from one common bond | | No. and (%) that would consider that the membership should come from several common bonds | | No. and (%) that would consider that the membership should be open to anyone who wants to join. | |
|--------------------------------------|--|--------------|---|--------------|---|--------------|
| | No. | % | No. | % | No. | % |
| Asset Category | | | | | | |
| Greater than €60m | 10 | 35.7% | 10 | 35.7% | 8 | 28.6% |
| Less than €60m but greater than €20m | 41 | 60.3% | 14 | 20.6% | 13 | 19.1% |
| Less than €20m | 30 | 55.6% | 6 | 11.1% | 18 | 33.3% |
| All credit unions | 81 | 53.6% | 30 | 19.9% | 39 | 26.5% |
| Common Bond Type | | | | | | |
| Community | 73 | 54.9% | 23 | 17.3% | 37 | 27.8% |
| Occupational and other | 6 | 37.5% | 7 | 43.8% | 3 | 18.8% |

Note: The total responses to this question in terms of asset size and common bond may at times differ given that some credit unions failed to identify their asset size and/or bond type.

4.12 Co-operative Values

4.12.1 Respondents were asked two questions about co-operative values. First, to what extent do you consider that the majority of the membership of your credit union *understands* the co-operative principles upon which the credit union is based? Second, to what extent do you consider that the majority of the membership of your credit union *continues to value* the co-operative principles upon which the credit union is based? Respondents were asked to allocate a score where 1 implied to a great extent and 5 implied not at all. Average scores are detailed in Table 13. Comparing the responses to the two questions it appears that across all categories considered there is a view that members value co-operative principles more than they understand co-operative principles. There is also a size differential with co-operative principles valued and understood less in large credit unions compared to their smaller counterparts.

Table 13 Co-operative Values

| Co-operative Values | Greater than €60m | Less than €60m but greater than €20m | Less than €20m | All credit unions | Community | Occupational and other |
|---|-------------------|--------------------------------------|----------------|-------------------|---------------|------------------------|
| | Average Score | Average Score | Average Score | Average Score | Average Score | Average Score |
| To what extent do you consider that the majority of the membership of your credit union <i>understands</i> the co-operative principles upon which the credit union is based? | 3.21 | 3.03 | 2.87 | 3.01 | 3.03 | 3.25 |
| To what extent do you consider that the majority of the membership of your credit union <i>continues to value</i> the co-operative principles upon which the credit union is based? | 3 | 2.88 | 2.37 | 2.72 | 2.78 | 2.5 |

4.13 Summary

- The board of directors is the primary driver of change in credit unions
- Attracting volunteers with key skills, training of staff and volunteers, technology used in service delivery, attracting and retaining young members, credit union image and leadership within the credit union were considered important internal constraints on development.
- Economic conditions, the regulatory authority, the regulatory framework and the

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leadership at movement level were identified as important external constraints on development.

- The business model of many credit unions will come under increasing pressure over the course of the next three years with an expected decline in income and static expenditure levels.
- Credit unions currently and increasingly in the future identify themselves as financial co-operatives providing their members with as full a range of financial services as possible.
- Five product/service lines are seen as potential service extensions by a substantive number of credit unions – debit/laser cards, online banking/online services, EFT, ATMs and insurance products and services.
- Shared services are viewed to be a critical element in the future development of credit unions, with sharing thought to be more appropriate on a regional or local basis rather than through centralised unit(s).
- The development of best practices, compliance, risk management, marketing and branding, debt collection, internal audit function and IT systems were functions where there was strong support for provision on a shared service basis.
- Most credit unions are satisfied with their IT provider.
- There is a limited appetite among credit unions for being absorbed into another credit union but willingness by credit unions to absorb others.
- Mergers, which represent an equal coming together, are positively received by a majority of credit unions, particularly larger credit unions.
- 50% of credit unions consider that the common bond should remain unchanged, 25% believe the common bond should be relaxed and 25% consider that credit unions should be open to all.

Chapter 5 - Synthesis Report on the Public Consultation

5.1 Introduction

- 5.1.1 This Synthesis Report summarises the key findings from the Public Consultation undertaken by the Commission. The purpose of the report is to inform and complement the Commission's discussion and this final Report of the Commission.
- 5.1.2 The Synthesis Report gives a flavour of the submissions. Except where it is indicated that the submission is to remain confidential, or otherwise deemed unsuitable for release, submissions will be published on the Department of Finance website.

5.2 Contributions

- 5.2.1 A request for contributions was posted on the Department of Finance website in July 2011. Views were requested on nine key areas. The advertisement is at Appendix 2. The deadline for responses was 25th August 2011.
- 5.2.2 A total of 119 contributions to the consultation were received. Contributions were diverse, with 63 submissions representing individual credit unions and the remaining 56 submissions representing private individuals, credit union Chapters, credit union IT providers, various associations, and other interested parties. A complete list of respondents is set out in Appendix 3. This Chapter sets out some of the themes emerging from the consultation process. In some cases extracts from particular submissions have been included where they help illustrate points in greater detail. These submissions represent a sample of opinion from the consultation process and were chosen following a careful reading of all the submissions.
- 5.2.3 Some organisations represented on the Commission made submissions as part of the public consultation as well as participating fully in the deliberations of the Commission and submitting documentation to it. Some members of the Commission opted to make the views of the organisations they represented known by their ongoing participation at Commission meetings and the submission of various written materials for consideration by the Commission.

Summary of Responses

5.3 The role of credit unions in the context of a restructured financial services sector

- 5.3.1 It was acknowledged by the majority of respondents that credit unions have an opportunity now to develop a key and more important role in the current financial services landscape. Some refer to this as an opportunity to become a '*third pillar*' to

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the existing two pillar banks.

- 5.3.2 Most submissions recognised the need for credit unions to remain member and community focused, to maintain a local presence and to retain the volunteer ethos.
- 5.3.3 The submission representing WOCCU (World Council on Credit Unions) acknowledged the key role credit unions play in offering and providing a lower price, competitive alternative for consumers post financial crisis recognising that “... credit unions play a critical role in providing lower price competitive alternatives for consumers” (WOCCU)
- 5.3.4 The CUDA submission, emphasised the greater need consumers have today for a strong, not-for-profit, co-operative financial system; however they continued to state that credit unions should not become solely a social lender.

“Accordingly, we reject any suggestion that credit unions should be recast into an entirely different new role as some kind of social finance provider or that they be relegated to acting as only a ‘poor man’s bank’.” (CUDA)

- 5.3.5 Conflicting opinions were raised regarding the function of the **common bond** in the context of modern financial services systems. Some argued for its complete removal as it was considered obsolete. Others suggested it should remain, if not in its current form in some other form, to retain the sense of ownership and identity it brings.
- 5.3.6 The combined Comhar Linn INTO, DUBCO and Health Services Staffs credit unions submission suggested broadening the common bond to compete for members, offer a broader range of services, allow for greater flexibility in investing policies and allow membership on a wider basis of common interest. This submission introduced the concept of ‘community stakeholder’ or ‘shareholder’. It was proposed that the narrow basis of locality and employment be broadened to a stakeholder concept, i.e. those who are economically connected through supplier or member links or are shareholders and have common interests, join the same credit unions. It is suggested the concept of membership is retained, although alternatives could be envisaged by asking members to sign a common charter to include values, ethics and terms and conditions.
- 5.3.7 The submission by Ballinasloe Credit Union Limited highlighted the impact the occupational common bond is having on a credit union operating under a common bond of locality/geography.

“The “occupational” common bond has to date damaged the geographical common bond in that it has removed from potential membership (of a local community credit union) the best paid workers of a locality i.e. teachers, Gardaí, health workers, electricians and telecom engineers etc and it has deprived the local credit unions of both the cash value of these potential members and their expertise in the governance of the credit union as well. (It is appreciated that the member has a choice in selecting a credit union and has chosen the occupational one)” (Ballinasloe Credit Union Limited).

- 5.3.8 Alternatively the Ballinasloe Credit Union Limited submission (and echoed by the Athlone Credit Union Limited submission) suggested a ‘common bond of services’.
“This implies that credit union members be serviced by their particular credit union to the maximum extent possible by delivering the services that members need on an

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ongoing basis. Services not available locally could be provided by other credit unions elsewhere.” (Ballinasloe Credit Union Limited)

5.4 Operating models for modern credit unions

5.4.1 The adoption of a ‘one size fits all’ model was widely rejected by the majority of submissions. Many respondents felt the need for a model which is flexible and allows individual credit unions to operate in a way which is tailored to their members’ needs. Some respondents were of the view that if the current model has survived successfully for the last 50 years, it will continue to do so in the future.

5.4.2 St. Raphael’s Garda Credit Union Limited highlighted the need for flexibility across the model:

“The model needs to be flexible enough to allow credit unions that have the capability to grow and flourish as a genuine alternative to the provision of personal financial services of the traditional banking sector.” (St. Raphael’s Garda Credit Union Limited)

5.4.3 The MABS submission identifies the challenges with the current model.

“The present operating model, while delivering appropriate services in the past, has shown that it is severely challenged given the new economic environment and consumer demand for different products and services” (MABS)

5.4.4 According to the MABS’ experience the current operating model leads to a different customer experience depending on location.

“This fragmented organisational structure has resulted in a lack of standardisation across the credit union sector, meaning that the customer experience differs greatly from one location to another.” (MABS)

“In order to facilitate the provision of modern financial services, credit unions will need to establish a common banking platform, common efficient processes, expand delivery systems, possibly through An Post, and develop more collaboration systems between unions.” (MABS)

5.4.5 UCC’s Centre for Co-operative Studies expressed that any changes introduced to the operating model of the credit union must evaluate the impact of credit unions competitive advantage, i.e. the trust they have with the community.

“Credit unions need to be careful that they do not move towards a transactional based relationship as this would erode their key competitive advantage” (Centre for Co-operative Studies, UCC)

5.4.6 Bill Hobbs submitted a detailed proposal for a new modern credit union model. In the context of a restructured landscape, the submission detailed simply a traditional savings and loans model, offering a wider variety of saving and lending products.

“To excel at their core business of savings and loans credit unions need to offer a much wider choice of modern savings and loans products along with learning how to “ask for

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the business” from their customers.” (Hobbs)

- 5.4.7 To facilitate this new model the submission explained how IT, operational systems and internal controls would need significant improvement to achieve and successfully operate this model.

- 5.4.8 Annette Kiely's submission proposed a three-tier model, where the lowest tier credit unions offer a limited number of services, and the highest tier offering the maximum number of services. As a result each tier would require proportional regulatory and financial viability criteria. The submission recognises the role of the common bond in this model:

“The disadvantage to such a three tiered model is that the membership within the common bond of that credit union will be at a disadvantage as the range of services available to them will be limited in comparison to a higher tiered credit union. It may then be worth reconsidering the limiting factor of the common bond restriction.” (Annette Kiely)

5.5 Options for restructuring

- 5.5.1 Very many respondents acknowledged the need for restructuring of the sector to reduce the number of credit unions and in turn centralise some services. However, many different suggestions were received on how to achieve this.

- 5.5.2 Some submissions argued for a completely voluntary merger and consolidation strategy to let the sector 'shape itself'. Others suggested a more organised and structured approach such as a main office and sub office structure based on geographical areas or on credit union Chapters.

- 5.5.3 A common concern relating to a restructuring process was the loss of local credit union offices. Many submissions stressed the need and importance of a local presence.

- 5.5.4 The UCC Centre for Co-operative Studies submission recognised local presence as a key competitive advantage and referenced some research in the area. The submission continued to say:

“The meaning of 'local presence' and 'community focus' must include not only a physical presence, but also an embedded presence which has a strong degree of local member ownership and control which in turn ensure that local community needs are the paramount consideration in all decisions” (Centre for Co-operative Studies, UCC)

- 5.5.5 One submission suggested a federated strategic network, modelled on a co-operative banking system globally.

“Envisaged is a citizen owned and governed federated financial co-operative system guided by credit union philosophy, values and ethos, offering a full range of consumer and small business banking products and services.” (Bill Hobbs)

Moving to a federated strategic network would require three important steps:

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- Network rationalisation through consolidation to realise scale of economies
- Transition to a new model credit union – the ‘savings and loans’ model
- Strengthening the financial infrastructure through contractual solidarity and cross guarantees to be effected by the establishment of a central finance facility.

- 5.5.6 The combined Comhar Linn INTO, DUBCO and HSS credit unions submission proposes a network structure, *“that would cluster smaller credit unions around central or key credit union(s) with the strength and capacity to support and build a wider network”*.

Key credit unions would be identified based on geography or employment sectors. These key credit unions would provide a hub for an infrastructure of governance, IT and services and sufficient capital to support the associate network. This submission believes the network structure could evolve in stages and allow for the smaller credit unions to ‘find their place’.

- 5.5.7 WOCCU presented a five step methodology for resolving credit unions which may no longer be viable due to “accumulated losses and unsustainable markets”.

- Take Stock of Existing Credit Unions
- Review & Sort Information
- On-site Diagnostics
- Initial Determination of Action (no action being an option)
- Stabilise, Merge or Liquidate

- 5.5.8 The submission by CUMA (Credit Union Managers Association) outlined some advantages and disadvantages to consolidation (see Table 1 overleaf).

“CUMA believes that amalgamations of credit unions that are financially sound, focused on strong corporate governance, dedicated to personal service and committed to their communities can, in carefully thought-out situations, be a positive development.”
(CUMA)

- 5.5.9 Some submissions highlighted the need to maintain liquidity throughout the sector during and following a restructuring programme to maintain stability across the sector.

5.6 Shared Services

- 5.6.1 There was a widespread acceptance of credit unions sharing services. A general acknowledgement and consensus was received that credit unions can benefit from the economies of scale that can be achieved from sharing services. Many credit unions suggested particular services of most benefit and they are outlined in Table 2 (overleaf). Back office duties were a particular popular choice for sharing.

- 5.6.2 While the need to share services was acknowledged, there were varying opinions on how to facilitate these services – credit union mergers, a centralised IT system, sharing via credit union Chapters or CUSOs.

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Table 1 CUMA Advantages and Disadvantages to Consolidation

| CUMA Advantages and Disadvantages to Consolidation | |
|--|--|
| Advantages | Disadvantages |
| Cost of delivering financial services spread over a wider membership | Empirical studies in the United States demonstrate that amalgamations do not necessarily result in efficiencies being achieved. |
| Better position credit unions to contain costs, introduce new products and improve service to members. | Negative impact on staff with likely redundancies. |
| Improved operating efficiencies | Complexities of merging cultures can cause governance difficulties at board level and at staff level. |
| Potential expansion of value added services to communities | Regulator prompted amalgamations requiring a large credit union to acquire a small under-performing credit union could affect overall service and cost efficiencies for members of the large credit union. |
| Some staff will potentially have access to more quality training and development programs and greater possibilities for advancement. | Transferring credit union and its community loses control over its local credit union office. |
| Cost of delivering financial services spread over a wider membership | Transferring credit union becomes a Branch Office. Branches are susceptible to closure, as evidenced by bank branch, post office and agricultural co-operative branch closures throughout the country. |

Table 2 Services suggested as suitable for sharing

| Services suggested as suitable for sharing | |
|--|---|
| IT & MIS | Utilities |
| Purchasing | Security & Disaster Recovery |
| Training | HR |
| Marketing | Website Maintenance |
| Credit Management & Debt Collection | Printing |
| Investment Advice | Offsite Storage (to facilitate smaller credit union premises) |
| Legal Advice | Central membership database |
| Auditing | Sharing part-time staff |
| Electronic payment/fund transfer | |

- 5.6.3 The submission by Balbriggan Credit Union Limited proposed the setting up of shared services centres that would be owned and funded by participating credit unions. The shared services entity could comprise of a board of directors drawn from the boards of participating credit unions. The new entity could manage the development and roll out of new income streams from new products to the members of all participating credit

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unions. The new entity would be managed independently of the participating credit unions.

- 5.6.4 The WOCCU submission discusses a similar concept. A Data Service Bureau facilitates the sharing of back office administration. As well as the benefit of lower prices, WOCCU outlined other benefits such as controls and policy parameters.

“Access to these services introduces a series of accounting disciplines, administrative requirements, internal controls, policy parameters and financial requirements into the credit union. The data services bureau also assists small credit unions with submitting required financial reports directly to the regulatory agency” (WOCCU)

- 5.6.5 There was a large consensus across the submissions that the standards of ICT need to be improved across the sector.

- 5.6.6 The combined submission by Grant Thornton, ICE Computer Services and IS Options detailed the challenges credit unions face in relation to ICT, and possible solutions. The submission highlighted a number of ICT risks that are present in the sector, many identified from experience in the sector such as:

- Lack of guiding policies and standards. Very few full time IT staff in credit unions means there is a strong need for guidance.
- In many credit unions ICT, governance and risk management practices are either informal and ad-hoc, or non-existent. This creates risks including business inefficiencies, security breaches, loss of data, failure to capitalise on business opportunities, amongst others.
- Security – control of user access, auditability of transactions, vulnerability of systems.
- No standardised definition for critical ICT system functionality in credit unions, prescribing detailed rules for processing of transactions, calculations, treatment of compliance requirements etc.
- Practices for testing and implementation of new and upgraded systems in the sector are not sufficiently formalised and frequently do not meet standards of rigour that are considered essential in other financial institutions

- 5.6.7 Grant Thornton, ICE Computer Services and IS Options and St. Raphael’s Garda Credit Union Limited submissions called for the Commission to consider the implementation of a set of standards and policies and assurance to stakeholders that these policies and standards are being implemented effectively.

- 5.6.8 Many submissions commented on the number of ICT providers available for the sector. Some believe there are too many; however it was noted that the more providers that are available the greater the level of competition, resulting in a reduced cost for the credit union.

5.7 Basic governance and regulatory requirements

- 5.7.1 The majority of submissions which addressed the topic of governance expressed a need for a form of basic governance standard, minimum competency requirement or fitness & probity regime. However, it was noted that the presence of such a

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requirement may make it more difficult to find suitable candidates for director positions. A number of submissions suggested the current nomination system “needs to be overhauled by the introduction of a comprehensive succession planning process”

- 5.7.2 A strong need for an induction programme and continued training regime for the directors of boards was suggested by numerous respondents. It was also suggested that a term of office for members of boards and committees should be defined.
- 5.7.3 The submission by the Centre for Co-operative Studies (UCC) stressed the importance of the role of the Supervisory Committee and called for its role to be strengthened and protected.
- 5.7.4 The creation of an internal audit function was discussed in some submissions; however there was no general consensus as to how the internal audit and supervisory committee would be structured or co-exist.
- 5.7.5 Many respondents stated that a tiered/proportional application of governance and regulatory requirements is required.
- 5.7.6 The capital or Regulatory Reserve Ratio was felt by many to be excessive. It was felt that it should reflect on the individual credit union’s risk, based on its size, investment policy, operating model etc.

“The current statutory obligations under the Regulatory Reserve Ratio (RRR), the basis for calculating capital in credit unions, has no direct link to the source of risk. The RRR is a crude and blunt instrument which does not take account of the risks faced by credit unions. A credit union with a higher risk profile does not have to hold a higher level of reserves than a credit union with a low risk profile. The RRR of 10% is too high and far in excess of the requirements on banks. The current requirements are unfair on credit unions and are hampering our ability to compete with other institutions” (Maynooth Credit Union Limited)

- 5.7.7 The combined submission by Comhar Linn INTO, DUBCO and Health Services Staffs credit unions discussed minimum capital requirements in line with Basel III requirements and risk weighted assets.
- 5.7.8 There were many strong requests for an appeals process to be established to enable credit unions to appeal any regulatory direction set by the Central Bank.

5.8 Financial Inclusion and Social Lending

- 5.8.1 Financial exclusion occurs where people “encounter difficulties assessing and/or using financial services or products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong.”¹⁴
- 5.8.2 In its submission on the issue of financial inclusion and social lending, MABS proposes that credit unions should work together with MABS to create a social lending mechanism which will facilitate financial inclusion.

¹⁴ Department of Finance, Strategy for Financial Inclusion Final Report, March 2011.

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MABS noted that, while recognising the need for the reorganising of the credit union movement on a strong financial footing in order to offer modern products and services to its members, it must also focus on the needs of the community in which it operates with a particular emphasis on those on low incomes and/or the marginalised. The MABS submission goes on to note that *“the future role of credit unions should involve local community development, financial education and information and the design and promotion of financial inclusion products as well as focusing on expanding its overall suite of products and services.”* (MABS).

- 5.8.3 In furtherance of the financial inclusion agenda a number of submissions advocated for the provision of a Basic Payment Account, a transaction account designed to improve access to transactional banking for the excluded. MABS also argue that a social lending product that is easily accessible and designed to compete with the sub-prime market should be provided by the credit union sector. In furtherance of this, it is argued that credit unions should be mandated to develop specific products and services dedicated to the needs of low income groups. This could be facilitated by easing the requirement that members have a good savings record before being able to take out a loan and instead allowing credit unions to give small loans at low interest rates. This mechanism would also require the provision of financial education to improve people’s awareness of and access to financial services. (MABS)
- 5.8.4 MABS also submits that Section 44 of the Credit Union Act 1997 should be amended to provide for a mandatory obligation on credit unions to establish a special fund with a specific allocation dedicated to a social lending purpose deriving from the annual operating surplus of a credit union.
- 5.8.5 In its submission, CUDA recognises that credit unions should continue to provide services to those who are unable to avail of financial services provided by banks, but that this must be balanced with preserving the strength of the credit unions and providing competitive services to members generally.

5.9 Recommendations for legislative change

- 5.9.1 Varying opinions were put forward regarding the Credit Union Act 1997 (the 1997 Act). Some submissions stated that it was serving its purpose well; other suggested a complete review or simplification of the Act or abolishment completely.
- 5.9.2 Table 3 indicates the sections in the 1997 Act that were highlighted by the respondents.
- 5.9.3 Repeatedly, Section 35, relating to the making of loans, was stated to be very restrictive.

“...we refer to Section 35 of the Credit Union Act 1997. Credit unions are being obstructed from assisting members in rescheduling debt and managing their deteriorating financial situation due to restrictions placed on them through regulation.”
(ASTI Credit Union Limited)

- 5.9.4 Some respondents wrote about the application process for the approval of new services as outlined in Section 48. They stressed how cumbersome and difficult this

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process is and requested a full review.

5.9.5 With regard to credit union unsecured debt, Balbriggan Credit Union Limited stated:

“Despite their not for profit mandate, unsecured credit union debt is treated in the same manner as all other unsecured personal loans and credit cards. The important role that credit unions play in offering credit to the financially excluded should be reflected in legislation which places a priority on credit union debt over other unsecured debts.”

5.9.6 Additionally, it was suggested that legislation should be provided for an appeals process against the Regulator, include recognition for social lending and to differentiate between the industrial and community credit union. It was also suggested that Transfer of Engagement legislation should be easier to implement.

Table 3 Comments & suggested amendments to the Credit Union Act 1997

| Section of the 1997 Act | Comments received |
|--|--|
| Section 21 Nomination of property in credit union | Retention should be a priority |
| Section 23 Provision for small payments on death | Retention should be a priority |
| Sections 27 -32 Shares and deposits | Amend Sections 27-32 to give credit unions flexibility in accepting deposits and offering share accounts that pay dividends at different rates and more frequently than annually. The concept of attachment of all savings to a loan should be removed Section 32 in its current state is not reflective of the changing times where credit unions need to offer current or payment accounts and day-to-day transactional banking such as debit and ATM cards. Section 32(3) of the Credit Union Act 1997, as it currently applies, provides a barrier to the credit unions in developing a proactive strategy towards developing a competitive EFT Strategy. |
| Section 35 Making of loans | Far too restrictive. Complete review requested. <i>“Section 35 restrictions should be revised upwards to allow credit unions address the severe negative effects of the banking crisis on members on a more realistic level”</i> |
| Section 36 Approval of loans | <i>“A member who has become a non-qualifying member is disadvantaged when it comes to loan approval. Some members may move a short distance outside the common bond and have always been good members. The Credit Committee could decide on these loans but still include them separately in their report to the Board of Directors”</i> |

Table 3 continued overleaf

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| Table 3 continued | |
|---|---|
| Section 41 Acquisition, holding and disposal of land | More clarification required. Specific clarity is desirable in relation to disposal of land and buildings or building only and the creation of sub leases as a means of disposal 41 (2) (3) and (4). |
| Section 43 Investments | <i>“The 1997 Act currently permits (Section 43(1) (c)) Credit Unions to invest surplus funds in the shares of a society registered under the Industrial and Provident Societies Acts (i.e., a co-operative). This provision is not reflected in the 2006 Guidance Note.”</i> |
| Section 44 Special fund for social, cultural etc. purposes | <i>“The provision, under section 44 of the Act, for the provision of a special fund to be established from the annual operating surplus should be made mandatory with a specific allocation dedicated to a social finance/lending provision.”</i> |
| Sections 48-50 Power to provide additional services | <i>“Provides for an elaborate application process for new services. However the entire concept needs to be overhauled and an appeals mechanism put in place.”</i> <i>“cumbersome and unnecessary conditions on the introduction of new services, thus denying credit unions the ability to respond quickly in meeting new members needs”</i> |
| Sections 63-65 Officers & functions | Amend to include the role of the manager and governance standards |
| Sections 84 Functions of the Bank | Amend to include an appeals process for credit unions in order to counterbalance the existing extensive powers of the Regulator. |
| Section 88 Procedural provisions relating to regulatory directions | Amend as too much power given to the Regulator |

5.10 Summary

5.10.1 This brief analysis highlights the points of strong consensus across the submissions.

Nine areas of consensus are:

- The role of credit unions is now more important than ever in the current financial services environment.

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- A 'one size fits all' model is not appropriate and should not be forced on all credit unions of varying sizes and business complexity.
- Restructuring is required.
- The sharing of services enables credit unions to reap cost benefits.
- Information Technology needs improvement and standardisation across the sector.
- Minimum governance standards and a fitness and probity regime should be implemented.
- Regulation should be proportionate to credit unions of varying sizes and complexity.
- Section 35 of the 1997 Act should be amended to reflect the financial inclusive nature of the credit union sector.
- An appeals mechanism should be created.

5.10.2 The above points of consensus are broadly in line with recommendations made by the Commission in its Interim Report as presented to the Minister for Finance on 30 September 2011. The consultation process further informed the second phase of this work.

Chapter 6 – International Perspectives

6.1 Introduction

- 6.1.1 The aim of this Chapter is to provide an overview of alternative financial co-operative models in Europe and North America. Models considered range from highly integrated complex federated structures (such as the European co-operative banks and the Canadian Desjardins caisses) to those based on loose alliances such as the atomised structures in the US, Canada and the UK. The discussion concludes with consideration of the strengths and weaknesses of the respective models.

6.2 Federated systems of financial co-operatives

- 6.2.1 Federated systems of financial co-operatives are highly integrated complex structures comprising a two or three tier system involving local, regional and national organisations. The system allows for internal governance and regulation. Local co-operatives have unified brand image, but retain independence and are member owned. The structure is based on the principle of shared resources.

6.3 Co-operative banks in Europe

- 6.3.1 Co-operatives in Europe were first formed in the mid-to-late 19th century. In many European countries, co-operative banks have developed prominent central institutions and formed network alliances. Networks range from loose associations to cohesive groups and can be simple or multi-levelled structures (Fonteyne, 2007). The level of integration ranges from centralisation of common services provided (such as group representation, strategic advice, and basic support services) to more executive functions (such as risk and liquidity management, management of mutual support, supervision of local banks, and mergers and acquisitions). Highly integrated and centralised systems can be found in Finland, France and the Netherlands. Austrian and German co-operative banks have delegated fewer functions to centrals while their Italian and Spanish counterparts are almost entirely decentralised (Ayadi *et al.*, 2010).
- 6.3.2 Co-operative banks have as their principle objective ‘*the satisfaction of their members’ needs and/or the development of their economic and social activities*’ and the principal motivation behind membership of a co-operative bank is access to services rather than a return on capital (EACB, 2006). Ownership is primarily in the hands of the members and the one person one vote principle is applied.
- 6.3.3 Most co-operative banks in Europe have now reached an advanced level of maturity. Consolidation has occurred through mergers of local co-operatives and acquisitions of private banks. Co-operative banks have diversified into commercial lending and corporate services while maintaining a local interaction through dense branch networks.

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In recent years, co-operative banks have increasingly distributed products and services through internet, call centres and automated teller machines (ATMs) (Groeneveld and Sjauw-Koen-Fa, 2009).

- 6.3.4 Members of co-operative banks are represented at a regional or national level by elected delegates. Non-executive directors (the supervisory organ) control the management of the co-operative and ensure compliance with regulations and policies (EACB, 2006).
- 6.3.5 Increased services are offered through integration at a higher level. These services may include advice, training, and education to member co-operatives and representation to external bodies. Furthermore, these higher level organisations may also operate as central banks for the local and regional co-operatives, providing liquidity facilities and managing a guarantee fund as well as providing IT services, product development and marketing. Such integration results in economies of scale for the local co-operatives. Box 1 provides an overview of models of federated co-operatives in Europe

Box 1 Models of Federated Co-operatives

| Box 1: Models of Federated Co-operatives |
|--|
| <p>France</p> <p>In France three of the top 5 banks in terms of asset size are co-operative banks:</p> <ul style="list-style-type: none">• Credit Agricole is one of the largest banks in Europe following the acquisition of Credit Lyonnais. The central body of Credit Agricole has been floated on the stock exchange to raise capital and to finance international growth.• Credit Mutuel is the second largest co-operative bank. This bank operates a three tier structure with the central bank supporting the regional and local banks. Some regional banks have also created their own central banks.• Caisse d'Epargne has evolved from a group of non-profit savings banks to become a co-operative bank in 1999. It now offers a full range of banking and financial services. Caisse d'Epargne adopts the three tier structure of central and regional banks mainly owned by the individual Caisses d'Epargne.• Banque Populaire is the third largest co-operative bank. This has a two tier structure with a Federal bank and 20 regional banks. These regional banks have 90 branches. |
| <p>Germany</p> <p>The banking sector in Germany can be split into three pillars: the savings banks (including local sparkassen), the co-operative banks and the large commercial banks.</p> <ul style="list-style-type: none">• The savings banks adopt a three tier model which has the Central DGZ DEKA Bank at the apex supporting the Landesbanken (which focuses on corporate clients) and the Sparkassen which are retail banks that operate locally and have an extensive branch network. |

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- The German co-operative banks are decentralised in nature. The Volksbanken and Raiffeisenbanken are independent institutions who can buy services from the two central banks when needed. There is a two tier structure in place consisting of local co-operative banks and the two central banks (DZ Bank and WGZ Bank). However the local banks are not governed by these central banks and are completely independent. The local banks and the central banks are partners within the FinanzVerbund, which is the umbrella organisation for all the co-operative financial institutions including leasing companies and mortgage banks. This structure enables the local banks to operate as all finance institutions.

The Netherlands

- Rabobank is also based on co-operative principles and offers a full range of financial services. It adopts a two-tier structure. The local banks are members of and shareholders of the supra-local co-operative organisation, Rabobank Nederland (RN). RN further acts as an international wholesale bank and as a bankers' Bank to the Rabobank Group. Although each individual co-operative bank is an independent legal entity, a cross-guarantee system is in place and reports are submitted on a consolidated basis. Rabobank aims to retain a commitment to maintaining its co-operative identity by ensuring a long-term relationship with customers (Groeneveld and Sjaauw-Koen-Fa, 2009). Rabobank owns many subsidiaries which operate as private/public companies offering services to member banks and their customers/members.

Finland

- The OP-Pohjola Group (formerly Oko Bank) is made up of independent member co-operative banks and the Group's central institution. It has a similar structure to Rabobank and the central institution (Pohjola Bank) owns several subsidiaries providing a range of services that enables the individual co-operatives to operate as an all finance institution.^x

6.4 Desjardins Caisses (Canada)

- 6.4.1 Desjardins caisses are similar in structure to the European co-operatives and operate along the lines of a complex federated model. They are also independent and autonomously incorporated entities, but operate in a structured, standardised and closely inter-connected environment with other affiliated caisse populaires. This system has become known as the Desjardins Movement and is primarily concentrated in the province of Quebec and parts of Ontario.
- 6.4.2 The Desjardin movement serves 5.5 million members and has an asset base of CDN\$121.5 billion. Between 2005 and 2010, the number of Desjardins affiliated caisse populaires declined from 608 to 476, membership size remained broadly constant and total assets increased by 45% (see Table 1).

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Table 1 Desjardins Caisse Populaires 2005 to 2010

| Year | Number of Caisses | Assets (\$millions) | Average asset size (\$millions) | Members | Average Membership Size |
|------|----------------------|------------------------|---------------------------------------|-----------|-------------------------------|
| 2005 | 608 | \$88,779 | \$146 | 5,588,302 | 9,191 |
| 2006 | 589 | \$95,030 | \$161 | 5,609,863 | 9,524 |
| 2007 | 575 | \$104,455 | \$181 | 5,663,192 | 9,849 |
| 2008 | 549 | \$112,291 | \$204 | 5,657,488 | 10,305 |
| 2009 | 509 | \$119,048 | \$233 | 5,570,809 | 10,944 |
| 2010 | 476 | \$128,744 | \$270 | 5,520,403 | 11,597 |

- 6.4.3 The base entities of the Desjardins group are the caisses populaire which are member-owned and deal with members on a day-to-day basis. The caisse is a distinct and independent entity. It has its own income statement and balance sheet and therefore has to constantly worry about its own bottom line, while working in congruence with the structure. There is no common bond rule and no demarcation line of membership so technically caisses can compete with each other, although most members of caisses generally come from the local town or village (Sriram, 1999).
- 6.4.4 Individual caisses are grouped into federations which in turn are integrated into one confederation. The role of the federation is to provide the caisses with common services in areas such as training, communications, technical support, human resources, and management of the caisse-federation network, credit and finance. However, the federations have decreased in importance over the last number of years due to the establishment of wholly-owned corporations which are subsidiaries of the central confederation which now tend to provide specialised support services to the individual caisses. These corporations include an insurance firm, an investment firm and a securities firm.
- 6.4.5 The Desjardins network is divided into 17 regions each with a Council of Representatives. The council consists of 15 members, 10 of whom are elected caisse populaire representatives and 5 are caisse populaire general managers. These individuals are elected by the individual caisse populaires on a proportionate basis with all having at least 1 vote and additional votes being allocated in increments of 5,000 members to a maximum of 6 votes for a caisse populaire with 25,000 or more members.
- 6.4.6 At the Council of Representatives each region elects a president who automatically becomes one of the 17 elected members of the Board of Directors of the Desjardins Group. Additionally, the regions each elect 15 representatives to the Assembly of Representatives. This body of 256 persons (17 regions x 15 representatives plus the president of the Desjardins Group board of directors) advises the management of the group regarding both strategic and operational planning as well as policy and by-law issues.
- 6.4.7 Overall, the current operating environment provides significant economies of scale and levels of industry presence and profile. Although there is significant autonomy at the individual caisse populaire, much of the strategic functions of the individual caisses operate through the democratic structure at the movement level. As a federated network this structure allows for the sharing and maximisation of both financial and non-financial assets and resources and is considered as both an effective and efficient structure.

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6.5 Atomised Systems (US, Canada and UK)

- 6.5.1 The atomised model of co-operatives consists of relatively weak integration of member credit unions, generally limited to representation, lobbying and public relations. In some jurisdictions, credit unions form Credit Union Services Organisations (CUSOs) which are limited liability companies to facilitate shared services. CUSOs allow credit unions to achieve economies of scale and/or engage in activities that credit unions are restricted from carrying out themselves. Corporate credit unions may also be established. They act as a 'credit union for credit unions' and provide a range of services primarily centred on treasury.

6.6 Credit Unions in the US

- 6.6.1 Credit unions in the US are organised in three tiers comprising natural person (or retail) credit unions, corporate credit unions, and the corporate central credit union. Natural person credit unions are owned by individual members voting on the basis of one member one vote and is not related to the amount of shares owned.
- 6.6.2 The US movement serves 90.5 million members and has an asset base of \$914.5 billion. Between 2005 and 2010, the number of US credit unions declined from 8,697 to 7,339, membership size increased by 7% and total assets increased by 35% (see Table 2).

Table 2 US Credit Unions 2005 to 2010

| Year | Number of credit unions | Assets (\$millions) | Average Asset size (\$millions) | Members | Average Membership Size |
|------|-------------------------|---------------------|---------------------------------|------------|-------------------------|
| 2005 | 8,697 | \$678,665 | \$78 | 84,506,880 | 9,716 |
| 2006 | 8,365 | \$709,949 | \$85 | 85,753,540 | 10,251 |
| 2007 | 8,102 | \$753,464 | \$93 | 86,837,478 | 10,718 |
| 2008 | 7,806 | \$811,067 | \$104 | 88,587,933 | 11,348 |
| 2009 | 7,553 | \$884,604 | \$117 | 89,918,956 | 11,905 |
| 2010 | 7,339 | \$914,475 | \$125 | 90,528,636 | 12,335 |

- 6.6.3 Originally credit union membership was restricted to a common bond. In 2003, the National Credit Union Administration (NCUA) released new field of membership rules for federal credit unions. The new rules expand what constitutes an occupational common bond and a community. Under the new regulations, for single common bond credit unions, an occupational common bond can include designations based on employment in a trade, industry, or profession. Therefore, a single common bond credit union can have a field of membership beyond a single employer if the members share the same profession or trade, or participate in the same industry. In addition, the NCUA regulations expand what constitutes a local community for the purpose of granting community charters.
- 6.6.4 Credit unions were initially distinguished by their emphasis on small value unsecured short term loans to individuals. However, credit unions in the US have since diversified

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to provide a wide range of services. Federal credit unions began to offer long-term mortgages to their members following legislative amendment allowing them to do so in 1977. A further legislative change in 1998 allowed credit unions to offer business loans, for commercial, corporate, business investment or property purposes, up to a maximum of 12.25% of assets. There has been a continued rapid increase in the amount of non-interest income being generated by credit unions since 2000 arising from diversification into areas such as stock and bond brokerage, mutual funds, financial planning and business checking.

- 6.6.5 Table 3 breaks down the lending categories of credit unions by asset size. From this it is shown that credit unions of all size categories offer each loan category, including mortgages. However, the larger the credit union, the greater concentration there is on first mortgage real estate and other real estate while smaller credit unions are more heavily concentrated on new and used car loans. In addition, it can be seen that most of the loan book is secured with 79% of loans of the smallest credit unions secured and 90.2% of loans of credit unions with assets greater than \$500m secured.

Table 3 US Credit Unions Loan Profile 2010

| Category | <\$10m | | \$10m-\$50m | | \$50m-\$100m | | \$100m-\$500m | | >\$500m | |
|-----------------------------------|--------------|------------|---------------|------------|---------------|------------|----------------|------------|----------------|------------|
| | \$m | % | \$m | % | \$m | % | \$m | % | \$m | % |
| Unsecured credit card | 138 | 2.6 | 1,495 | 4.9 | 1,611 | 5.1 | 6,940 | 5.1 | 25,774 | 7.1 |
| All other unsecured | 994 | 18.5 | 2,794 | 9.1 | 1,974 | 6.2 | 6,262 | 4.6 | 13,451 | 3.7 |
| New vehicle | 1,169 | 21.7 | 4,226 | 13.8 | 3,845 | 12.1 | 14,897 | 11.0 | 38,759 | 10.7 |
| Used Vehicle | 1,839 | 34.2 | 8,049 | 26.4 | 7,855 | 24.6 | 28,413 | 21.0 | 55,367 | 15.3 |
| First mortgage real estate | 387 | 7.2 | 7,222 | 23.7 | 9,527 | 29.9 | 48,518 | 35.8 | 15,7398 | 43.5 |
| Other real estate | 370 | 6.9 | 4,398 | 14.4 | 4,927 | 15.4 | 22,057 | 16.3 | 54,813 | 15.2 |
| Leases receivable | 487 | 9.0 | 2,356 | 7.7 | 2,157 | 6.8 | 8,384 | 6.2 | 15,967 | 4.4 |
| Total loans | 5,384 | 100 | 30,540 | 100 | 31,896 | 100 | 13,5471 | 100 | 361,532 | 100 |

- 6.6.6 Table 4 sets out the sources of income of credit unions broken down into five asset bands. This table shows that as credit union size increases the share of interest income from loans declines but still accounts for a large share of total income (74.5% for credit unions with assets less than \$10m; 66.2% for credit unions with assets greater than \$500m). While fee income makes up about 10% of total loan income across size bands, the contribution of other operating income steadily increases as credit union size increases.

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Table 4 US Credit Unions Income Profile 2010

| Category | <\$10m | | \$10m-\$50m | | \$50m-\$100m | | \$100m-\$500m | | >\$500m | |
|----------------------------------|------------|-------------------|--------------|-------------------|--------------|-------------------|---------------|-------------------|---------------|-------------------|
| | \$m | % of total income | \$m | % of total income | \$m | % of total income | \$m | % of total income | \$m | % of total income |
| Interest on loans | 417 | 74.5% | 2,114 | 68.3% | 2,107 | 66.8% | 8,464 | 65.5% | 21,405 | 66.2% |
| Income from investments | 76 | 13.6% | 438 | 14.1% | 395 | 12.5% | 1304 | 10.1% | 3,404 | 10.5% |
| Total interest income | 492 | | 2,550 | | 2,499 | | 9,761 | | 24,796 | |
| Fee income | 59 | 10.6% | 462 | 14.9% | 508 | 16.1% | 2,171 | 16.8% | 3,848 | 11.9% |
| Other operating income | 14 | 2.5% | 148 | 4.8% | 204 | 6.8% | 1,044 | 8.1% | 3,496 | 10.8% |
| Other | (6) | | (62) | | (55) | | (63) | | (215) | |
| Total non-interest income | 67 | | 548 | | 657 | | 3,152 | | 7,559 | |
| Total income | 559 | | 3,098 | | 3,156 | | 12,913 | | 32,355 | |

- 6.6.7 US credit unions operate under a Prompt Corrective Action (PCA) framework. It applies to credit unions deemed to be experiencing capitalisation difficulties. It defines five categories of capitalisation in terms of the ratio of net worth to assets: well capitalised, 7% or more; adequately capitalised, 6-6.99%; undercapitalised, 4-5.99%; significantly undercapitalised, 2-3.99%; and critically undercapitalised, below 2%. A risk-based net worth requirement was also put in place for complex credit unions.
- 6.6.8 Credit unions classified as well capitalised or adequately capitalised are free from supervisory interference under the PCA system. Credit unions classified as undercapitalised or below are required to take progressively more radical steps to restore net worth to adequate levels. The NCUA follows a number of mandatory actions for credit unions that do not meet capital standards. These include: the requirement of annual earnings retentions of greater than 0.4% of total assets; the submission and adherence to a net worth restoration plan; prohibit any increase in credit union total assets until net worth is restored; and restrict the number of member business loans. The NCUA can use fourteen supervisory actions to supplement the aforementioned mandatory measures.
- 6.6.9 The overall consequence of these reforms was changes in the patterns of growth across different types of credit unions. Larger credit unions tended to grow faster than their smaller counterparts (Goddard, McKillop and Wilson, 2002). Much of this growth was via diversification into non-interest earning activities, albeit that this did not lead to enhanced returns for members (Goddard, McKillop and Wilson, 2008). Externally generated growth also took place via acquisition and merger, whereby larger, well capitalised and technologically advanced credit unions acquired smaller, less capitalised counterparts that failed to adopt interactive and transactional internet banking technologies (Goddard, McKillop and Wilson, 2009). Overall, the sector has become more concentrated over time. Nevertheless recent evidence suggests that many credit unions are still too small to take full advantage of scale economies (Wheelock and Wilson, 2011).
- 6.6.10 The NCUA uses the CAMELS system to reflect a credit union's financial condition, its compliance with laws and regulatory policies, and the quality of its management and

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systems of internal control. Credit unions are rated on a scale from 1 (best) to 5 (worst). In 2010, the NCUA rated 14.4% of credit unions 1; 55.9% 2; 24.8% 3; 4.6% 4 and; 0.3% 5.

- 6.6.11 US credit unions employ Credit Union Services Organisations (CUSOs) as a means of achieving economies of scale through the sharing of resources while allowing credit unions to maintain their individual identity and independence and/or allow credit unions to engage in activities they would normally be restricted from doing.
- 6.6.12 CUSOs are set up as limited liability companies or limited partnerships by alliances of credit unions to provide specific financial and operational services for member credit unions. The services permitted include the sale of securities and insurance products, mortgage and other loan origination, data processing, trust services, credit card, automated teller machine, and debt collection services, among others.
- 6.6.13 Corporate credit unions also operate in the US. They are not-for-profit financial co-operatives that serve retail credit unions within their field of membership. Corporate credit unions are totally owned and directed by their member credit unions that have equal voting rights. Corporate credit unions offer a range of services including investment services, credit and liquidity management services, payment services (cheque/image processing, Automated Clearing House, coin and currency, wire transfers, bill payment, remote deposit capture services, cash management services), brokerage services, and educational and training services. Corporate credit unions were created in the 1970s as a source for liquidity for their member credit unions during periods when deposits were low. Box 2 below provides a discussion of the recent evolution of corporate credit unions.

Box 2 Corporate credit unions – a case study of a sector in crisis and responses

Box 2: Corporate credit unions – a case study of a sector in crisis and responses

Within the US credit union movement corporate credit unions provide lending, investment, and processing services for their member credit unions. De-regulation in the late 1990s expanded the investment opportunities of corporate credit unions.

Corporate credit unions increasingly competed with each other to attract funds from member credit unions. This, along with the low returns on traditional types of investments, caused corporate credit unions to shift to risky investments to generate higher returns. For example, larger corporate credit unions began investing in more non-government agency mortgage backed securities. This led to an increase in the concentration of mortgage related securities as a proportion of total investments, reaching 35% in 2007. NCUA issued supervisory directives in mid-2007 prohibiting corporate credit unions from further purchase of non-governmental-agency mortgage-backed securities.

However, by that time the US financial system was experiencing a financial crisis. In late 2008, estimates suggested that corporate credit unions faced losses of \$33 billion on investments, and only had \$2.4 billion of retained earnings to cover such losses. The remainder of the losses would be covered by consumer credit unions' paid-in and membership capital in the first instance, then the share insurance fund

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(for insured accounts only), with the remainder (and majority) absorbed by consumer credit unions.

Unsurprisingly, member consumer credit unions reduced their deposits at corporates with the total declining from \$91 billion in February 2008 to \$59 billion in December 2008.

If consumer credit unions had been left to absorb the losses from corporate credit unions, it is likely to have led to around 30% of credit unions failing. The NCUA, in cooperation with the Federal Reserve Board and the Department of the Treasury, instated a series of measures to stabilise the system and resolve problems at individual corporates by isolating distressed assets.

In 2008, the NCUA gained approval from Congress to increase the Central Liquidity Facility lending limit from \$1.5 billion to \$41.5 billion. This allowed the NCUA to institute a number of measures in 2008 and 2009, which included: The Temporary Corporate Credit Union Liquidity Guarantee Program; The Credit Union System Investment Program; and the Credit Union Homeowners Affordability Relief Program.

In January 2009, the NCUA issued a \$1 billion capital note to U.S. Central Corporate Credit Union paid from the National Credit Union Share Insurance Fund (NCUSIF). A Corporate Stabilisation Plan was introduced which created the Temporary Corporate Credit Union Stabilisation Fund. The \$1 billion capital note was assigned to this fund and the NCUSIF was repaid. The Temporary Corporate Credit Union Share Guarantee Program provided an NCUA guarantee of all shares in corporate credit unions with the exception of paid-in capital and membership capital.

In March 2009, the two largest corporate credit unions, US Central and Western Corporate experienced further liquidity problems and were placed in conservatorship under the NCUA. This was followed later in 2009 and in 2010 by Constitution, Members United and South West Credit Unions. These five corporate credit unions represented 70 percent of the entire industry assets and more than 98 percent of the investment losses. The NCUA undertook to resolve any bad assets by placing bad assets in an asset management estate and establishing a Securitisation Trust. Cash flows from these bad (or legacy assets) were repackaged into marketable securities guaranteed by the NCUA (known as the NCUA Guaranteed Note Initiative). By the end of 2010, this program helped isolate over \$50 billion of legacy or distressed assets. The NCUA also created bridge corporate credit unions which took over all shares and purchase and assumed any good assets. These bridge corporate credit unions continue to operate and offer services until member credit unions find alternative providers.

The NCUA has instituted changes to Part 704 of the Rules and Regulations governing corporate credit unions. The new rule makes provisions for: changes to capital standards; a system of Prompt Corrective Action; revisions to permissible investments; reforms of corporate governance and increased disclosure. At the time of writing a consolidation and restructuring process is taking place. This has seen a number of mergers which has reduced the number of corporates from 27 prior to the financial crisis down to 15.

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6.7 Credit Unions in Canada (atomised)

6.7.1 In Canada, there are two distinctly separate sectors within the overall financial co-operative movement - the highly integrated federated model of the Desjardins movement (discussed earlier) and the more loosely integrated atomised model of credit unions which are more typical of credit unions in the US. These operate as independent and distinct entities with industry-wide services offered through the various Credit Union Centrals (Goth, McKillop and Wilson, 2012).

6.7.2 The number of atomised credit unions in Canada has decreased steadily through mergers and rationalisation as credit unions seek to reduce overheads, adopt new technology and offer better products. Numbers declined from 524 to 386 from 2005 through to 2010, however assets increased by 50% and membership by 4% (see Table 5).

Table 5 Atomised Canadian Credit Unions 2005–2010

| Year | Number of credit unions | Assets (\$millions) | Average Asset size (\$millions) | Members | Average Membership Size |
|------|-------------------------|---------------------|---------------------------------|-----------|-------------------------|
| 2005 | 524 | 87,145 | 166 | 4,855,057 | 9,265 |
| 2006 | 498 | 95,127 | 191 | 4,990,511 | 10,021 |
| 2007 | 465 | 104,735 | 225 | 5,017,397 | 10,790 |
| 2008 | 440 | 113,893 | 258 | 5,052,972 | 11,484 |
| 2009 | 419 | 121,927 | 290 | 5,043,071 | 12,036 |
| 2010 | 386 | 130,962 | 339 | 5,056,373 | 13,099 |

6.7.3 There has also been consolidation amongst the Centrals across provincial lines. This includes the merger of the four Maritime Provinces into Atlantic Central, while Ontario and British Columbia have amalgamated to form Central One. These Centrals facilitate a system of shared services in areas such as risk management, human resources, consulting and support, and marketing and communications planning. Furthermore, insurance, technology, education and wealth management services may be offered through the Central's ties to the Credit Union Central of Canada (CUCC), other provincial centrals and agencies and various affiliated organisations. (Goth, McKillop and Wilson, 2012).

6.7.4 Under new legislation passed in 2010, credit unions and caisse populaires can now carry on business across Canada and are not limited along provincial lines under the supervision of a single regulator and can amalgamate with credit unions in different provinces. Although these changes provide development opportunities for credit unions, there is also a concern that it increases the 'gap' between the member and the credit union.

6.8 Credit Unions in the UK

- 6.8.1 Credit union development in the UK has been varied (McKillop, Ward and Wilson, 2010, 2011). In Northern Ireland (NI), the credit union movement is relatively strong. There are also areas of significant strength in Scotland, particularly in the west of Scotland (McKillop and Wilson, 2008). At the end of 2010, there were 613 credit unions in the UK with a membership of 1,268,971 and total assets of approximately £1,674 million. Of this number, 177 credit unions are based in NI where they control £920.7 million in assets and have a membership of 431,605. Approximately 23.6% of the population in NI are credit union members compared to 1.6% in Great Britain (GB).
- 6.8.2 There has been a consistent decline in the number of credit unions in GB since 2003, mainly resulting from transfers of engagements to other credit unions. In June 2003, there were 619 credit unions in GB with this reducing to 436 by September 2010. This decline has been in the form of credit union failures, transfer of engagements and amalgamations (McKillop, Ward and Wilson, 2011). Meanwhile, there has been growth in assets and membership sizes of the remaining credit unions partly due to credit unions in GB now being able to offer banking services to members beyond basic savings and loans (McKillop, Ward and Wilson, 2011).
- 6.8.3 The Financial Services Authority (FSA) took over regulatory control of credit unions in GB in 2002. The FSA's regime also extends to the protection of credit union members' funds under the terms of the Financial Services Compensation Scheme (FSCS). The FSA took over regulatory control of credit unions in NI in March 2012.
- 6.8.4 The most recent changes to the Credit Unions Act 1979 came into force on 8 January 2012. The Legislative Reform (Industrial & Provident Societies and Credit Unions) Order 2011 (LRO) allows credit unions in GB (i) to provide services to different groups of people within one credit union; a 'field of membership test' makes sure it is possible for all potential members to be served by the credit union. Credit unions whose 'common bond' includes a geographical area are limited to two million potential members; (ii) to choose to offer membership to unincorporated associations and corporate bodies such as companies, partnerships and social enterprises; (iii) to offer interest on savings, instead of a dividend and (iv) to set their own limits on 'non-qualifying members' (a credit union prior to 2012 was limited to having 10% of 'non-qualifying members' at any one time).
- 6.8.5 Credit unions in GB also play a prominent role in the Government's financial inclusion agenda and receive support through the Growth Fund administered by the Department of Work and Pensions. Credit unions have been tasked with the aim of helping to achieve the Government's aim of increasing access to basic banking services, affordable credit and free money advice (McKillop, Ward and Wilson, 2011).
- 6.8.6 Credit unions are now categorised into Version 1 and Version 2 credit unions. A Version 1 credit union is more restricted in the activities it may engage in. A Version 1 credit union may not lend more than £15,000 in excess of member shareholding and must maintain a capital ratio of 5% if it wishes to lend in excess of £7,500. Version 2 credit unions can lend greater amounts for greater periods but must maintain higher levels of capital (along with version 1 credit unions with assets greater than £10 million or membership greater than 10,000) and have greater liquidity and supervision requirements.

6.9 Strengths and weaknesses of Federated and Atomised Systems

6.9.1 Federated System: European Co-operative Model

Main Features

- Consolidated credit unions operate a central facility as a wholesale commercial enterprise serving constituent member banks.
- Individual member banks are the owners and users of the central facility.
- This facility provides services such as IT, liquidity access, central banking services and monitoring.
- Customers who are not members may avail of the services of the co-operative banks.
- Members of the member banks are represented at regional level by delegates to a regional delegate assembly which in turn forms part of the central delegate assembly. This acts as the consultative body for member banks.

Strengths

- The central facility allows for the provision of a greater range of services to members such as insurance, credit cards and asset management. These aspects may be established as subsidiaries of the central facility.
- There is extensive integration between member banks including cross capitalisation.
- Individual member banks retain independence.

Weaknesses

- It is a one size fits all model.
- A cross guarantee system is in place meaning that all member banks are liable for the obligations of all other members and the group as a whole.
- There is a risk that decisions are made on a top down basis.

6.9.2 Federated System: Desjardins Caisse Populaires

Main Features

- Tightly controlled branch networks of local caisses are grouped into regional federations.
- Regional federations feed into the centralised confederation.
- Individual caisses have their own identity.
- The size and scale of the caisses are to an extent controlled by the regional organisation.

Strengths

- There is support from the regional federation and central confederation.
- Services such as training, IT, liquidity support facilities are provided centrally.
- There is a unified brand image and standardisation of services.
- There is an increased ability to provide a broad range of services through wholly-owned subsidiaries of the central institution.
- Local presence is maintained through an extensive branch network.

Weaknesses

- This may result in a one-size-fits-all model.

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- There is a potential dilution of member-control. There is a risk that decisions are more top down rather than coming from the membership.
- There is a risk of a dilution of local autonomy.

6.9.3 *Atomised Model*

Main Features

- Credit unions are autonomous with a well developed local presence.
- While maintaining individual and independent credit unions increased integration can be achieved through shared services (such as in the US and Canada).
- CUSOs, built on member credit union capital, are the preferred mechanism to allow for the provision of back-office shared services.
- In developed atomised systems there is a role for corporate credit unions to provide banking and treasury facilities to member credit unions.
- Failing or failed credit unions are invariably resolved and possibly subject of a transfer to another credit union.

Strengths

- Local autonomy is retained.
- Local presence is maintained.
- There may be integration on a less formal basis than in federated models through the use of shared services and CUSOs.
- Increased services to participating credit unions from the establishment of corporate credit unions.
- Individual credit unions choose their level of involvement in shared initiatives.

Weaknesses

- While credit unions are independent, weakness and failure of some credit unions may result in a shock to the system and contagion effects.
- The failures of certain corporate credit unions in the US have led to a significant increase in resolution and stabilisation costs.
- A lack of or limited use of shared ventures may result in individual credit unions being subject to a higher cost base.

Chapter 7 – Future Models of Credit Unions

7.1 Introduction

7.1.1 The Commission has taken a view of credit unions at sector level using the following principles to develop an overall framework:

- The ability to meet members' needs now and into the future
- Preservation of the core credit union ethos
- A sector which is stable and self-sustaining financially throughout the business cycle
- A modern legislative and regulatory basis

7.1.2 Within this framework, credit unions will need to decide on a vision for their own organisations. As the Commission survey results clearly show, leadership is a big issue. Credit union boards are expected – by the sector itself – to become the main drivers of change. In simple terms, this is likely to be done by asking a question about what needs to change if the members' needs are to continue to be met over time, while ensuring that the credit union remains viable and sustainable.

7.1.3 The Commission believes that the operating environment for credit unions is changing. There are also underlying weaknesses in the credit union model which points to the need for credit unions – including strong ones – to undertake a timely evaluation of their thinking on where they are headed.

7.2 Operating environment

7.2.1 As Chapter 3 shows, a number of weaknesses have been identified in the sector:

- Costs have almost doubled, driven primarily by increases in provisions, and income has declined.
- Credit unions are significantly under-lent. The average loan to asset ratio as at 31 December 2011 was 40.76%, an historic low. As a consequence, the share of investment holdings by Irish credit unions is high. This adversely impacts upon income generation as the return from investments tends to be lower than interest receivable on loans.
- Since 2007, credit unions have suffered a sharp decline in their return on assets, which by 30 September 2011 had fallen to 0.6%.
- There is evidence of a wide disparity in credit union performance with larger credit unions tending to perform better than their smaller counterparts.

7.2.2 Looking ahead, there is also a range of challenges facing credit unions:

- A modern regulatory framework will require investment in systems, skills and

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expertise and a new way of working. These will lead to additional costs and point to the need to find new economies of scale.

- Changes in members' needs and the nature of the credit union sector itself will present challenges for credit unions looking to develop their business over the coming years.
- Credit unions, in general, need to produce additional income which could be generated from, inter alia, expanding the range of products and services that credit unions provide.
- The financial sector is changing, both through the restructuring of the banking sector and through new business models used by new entrants in the market for credit provision. Credit unions will be competing with large multi-product banks on one side – with their ability to cross-subsidise products to attract customers – while on the other side there are nimble innovative credit providers, targeting young and technology-oriented customers.
- The credit union brand is not being marketed to its full potential and the level of movement-wide collaboration on projects of common interest could be better. There is a risk that the brand could become outdated over time as the membership base ages without renewal, and financial weaknesses in the sector could undermine public confidence in credit unions as a safe place to save.

7.2.3 However, credit unions have survived and grown over many years and in many countries, demonstrating what can be achieved by a volunteer-led not-for-profit movement. This has been possible because the credit union sector enjoys intrinsic strengths. The credit union ethos has allowed credit unions to carve a niche in the market and differentiate themselves from other players in some important ways:

A different purpose: The primary purpose of co-operatives is to meet the common needs of their members, whereas the primary purpose of most investor-owned businesses is to maximise profit for shareholders.

A different control structure: Co-operatives use the one-member/one vote system, not the one-vote-per-share system used by most businesses. This helps the co-operative serve common needs rather than the needs of a handful of individuals. It is also a way of ensuring that people, not capital, control the organisation.

A different allocation of profit: Co-operatives share profits among their member-owners on the basis of how much they use the co-operative, not on how many shares they hold. Most co-operatives invest a significant portion of their profits in improving service to members and promoting the well-being of their communities.

7.2.4 In Ireland, the high membership levels among credit unions and the nationwide spread has given the sector close to universal coverage, while at the same time nurturing a community focus which has supported customer (which usually means member) loyalty.

7.2.5 While there are certainly challenging times ahead, the future is not without its opportunities for credit unions. The restructuring of the banking sector creates an

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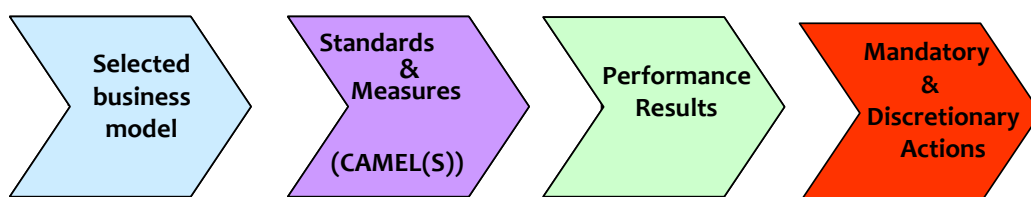
opening for credit unions in the space previously occupied by mutuals. The negative public sentiment towards banks arising from the financial crisis creates an opportunity for credit unions to attract new members or meet a greater share of the financial needs of its existing membership. If credit unions can reduce their cost base through economies of scale and scope, while improving their income stream through the provision of a wider range of products or expanding existing lending, then there is an opening for credit unions to become a third pillar of the Irish financial system.

7.3 Volunteers

- 7.3.1 In a credit union, volunteering can range from front-line delivery of services to participation at board level. The latter involves engagement with high-level decision making on the overall strategy and governance of the credit union. As an individual credit union's volunteer pool is restricted to its common bond, it may be difficult to attract volunteers with the required financial and business expertise.
- 7.3.2 As volunteers are crucial to the continued success of the movement, it is important that credit unions consider fully the role of volunteers when planning their business strategy. The difficulty in recruiting volunteers could be addressed through a planned effort by credit unions to seek-out potential candidates with the necessary levels of skill and commitment. Greater use of succession plans and volunteer development strategies are recommended.
- 7.3.3 Given that this is likely to be a movement-wide issue, there may also be a role for representative bodies in providing promotion and marketing, as well as advice on how best to identify, engage and train new volunteers.

7.4 How can credit unions find the right fit for their members within a tiered approach?

- 7.4.1 The following framework is presented as a means of assisting credit union boards as they choose the business model through which they aim to achieve their vision.



- 7.4.2 The critical decision that the credit union board must make is selecting the range of products and services it wishes to offer its members. This can vary from a simple savings and loans model to a more complex and broader product range model. The selection must ensure that the value proposition required to recruit new members and the value proposition required to retain members will generate sufficient income to earn appropriate surplus.
- 7.4.3 There will be baseline governance, prudential and operational standards to be achieved and this will increase as the complexity of the business model and size of the credit union increases. The board, will factor in the cost of meeting the standards

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relevant to the model they are considering, which in turn will assist in the determination of a suitable model.

- 7.4.4 Key measures, that reflect the complexity and size of the credit union, will help board and management assess performance against its strategic and business plans and against its peers. The performance results and trends may impact the required regulatory approach as part of the Central Bank risk-based supervision model. This transparent, predictable approach will also assist boards make strategic decisions in a timely and relevant manner.

7.5 Regulatory environment

- 7.5.1 Credit unions will not be able to capitalise on these opportunities unless they have the necessary governance, skills, expertise, systems, controls and resources to allow them to meet the regulatory requirements. The Commission is of the view that direct supervision of all credit unions by a single government regulator with statutory responsibilities ensures uniform standards and promotes greater member confidence, with confidence further enhanced through regulators trained in the nature, risk and methodologies of credit unions. Credit unions operate in a regulatory environment that aims to ensure the financial soundness and rectitude of individual credit unions and, in so doing, aims to safeguard the movement as a whole. An effective regulatory framework is built upon a legislative framework that is prudential, proportional and predictable. Sound regulation provides reassurance to members and provides a reputational safeguard to credit unions and the credit union brand.
- 7.5.2 The Commission considers that key to effective supervision is the two-way flow of timely and good quality information. The Commission is also of the view that this two-way flow of timely and good quality information can help address the point raised in the survey returns and consultation process that the regulatory authority and the regulatory framework constrains credit union development. This information flow should be achieved through (i) on time submission of quarterly and annual reports which facilitate off-site monitoring by the regulator (ii) on-site monitoring by the regulator (or appointee) determined by the risk presented and/or significant changes in operating environments for credit unions (iii) information sessions provided by the regulator to credit unions on an individual and/or group basis¹⁵, (iv) consultation and consultation protocol, (v) regulatory impact analysis, and (vi) an appeals mechanism.
- 7.5.3 The survey returns identified both the current regulatory authority and the regulatory framework as considerable external constraints on the development of credit unions. Larger credit unions considered this to be much more of an issue than smaller credit unions. This suggests that credit unions have some reservations about the present regulatory authority and the regulatory framework.
- 7.5.4 Achieving an optimal balance in regulation and supervision is difficult in the current uncertain economic environment and some degree of tension between the regulator and the regulated must always be expected. Clearly, an effective regulatory and

¹⁵ In the UK, the Financial Services Authority (FSA) provides assistance and guidance to credit unions, including offering 'surgeries' of up to one hour at convenient locations. The FSA seeks to offer each credit union a surgery at least once every three years. These surgeries are free.

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supervisory framework can help facilitate the prudent development of credit unions. In contrast, a regulatory and supervisory framework that is too strict risks curtailing development, while one that is too lax may lead to credit union failures placing the movement as a whole in jeopardy. Furthermore, identifying the effective framework is made more difficult because one size does not fit all. Some credit unions are small and offer a restricted product range, whereas others may be larger providing a more extensive product portfolio.

7.5.5 The Commission believes that the regulatory and supervisory framework must be flexible enough to accommodate different types of credit union with a calibrated approach for smaller, product restricted, credit unions. The Central Bank risk-based approach to supervision (PRISM^{xi}) seeks to do this. This supervision model will allow for varying degrees of engagement with regulated entities depending on the potential impact on financial stability or on consumers as a result of failure of the entity. Credit unions will be categorised as high impact, medium-high impact, medium-low impact or low impact, which will determine the number of supervisors assigned and level of engagement with each credit union.

7.5.6 While PRISM offers a model for risk-based supervision, the Commission recommends that a tiered approach be taken in relation to the regulation of credit unions¹⁶.

7.6 Tiered Regulatory Approach

7.6.1 The Commission recognises the importance of the introduction of a strengthened regulatory framework for the credit union sector which will include additional requirements in several key areas such as governance, fitness and probity and risk management. However, it is important to ensure that the regulatory requirements in place for credit unions are proportionate to the nature and scale of the credit union. In recognition of this, the Commission recommends a tiered regulatory approach.

7.6.2 Given the range in asset sizes of credit unions and having regard to the additional risk that can arise from increased scale, it is recommended that asset size be the primary basis for the development of a tiered regulatory approach. It is proposed that within this approach there would be three separate types of credit unions largely based on asset size. The next sections and the Annex to this Chapter illustrate how this regime could operate.

7.6.3 Type 1 – (Less than €10m asset size): This type of credit union would operate a simple business model. Regulatory requirements would be applied proportionate to the level of risk. For example, the level of requirements in relation to governance, fitness and probity and risk management would not be the same as those applying to other types of credit unions. The maximum savings amount per member could be €50,000. A maximum loan amount in excess of shares could be specified and the maximum term for a loan could be limited to a period of 5 years. Similarly investments could be made with maturities of up to one year (e.g. bank deposits). These credit unions would be permitted to offer any exempted additional services.

7.6.4 Type 2 – (€10m to €100m asset size): Credit unions of this type would be able to offer a

¹⁶ Broadly speaking, regulation refers to the requirements credit unions have to comply with whereas supervision relates to the way the regulator oversees compliance with those requirements.

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similar range of services as provided for under the existing regulatory framework. Where appropriate, existing regulatory requirements would be reviewed to ensure that they are appropriate to the level of risk in the business model. As well as exempted additional services, credit unions in this type that want to provide further additional services as part of their business model may be required to obtain approval from the Central Bank or may be required to meet specific requirements set by the Central Bank depending on the nature of the specific service and the nature, scale and complexity of the credit union.

- 7.6.5 Type 3 (Greater than €100m asset size): Credit unions with assets in excess of €100m would be permitted to undertake a wider range of investment and lending activities than other credit unions. These credit unions would be subject to additional prudential requirements and would be required to have risk management systems, procedures, controls, skills and expertise appropriate to the complexity of their business model. Under such a framework, it may be appropriate for credit unions in this type to provide certain additional services once they comply with any specific requirements set by the Central Bank.

Introduction of a Tiered Regulatory Approach

- 7.6.6 It is recommended that transitional arrangements are provided to facilitate the introduction of a tiered regulatory approach. As part of the transitional arrangements, and before the introduction of the tiered regulatory approach, where a credit union has assessed the credit union type within which it falls, based on current asset size, it may wish to consider whether it is capable of and wishes to operate in another category. Where this is the case, and a credit union has carefully considered the requirements that apply to the other category and determined that it is capable of meeting these requirements, the credit union may make an application to the Central Bank to be re-categorised to another type.
- 7.6.7 Any such application will be subject to the requirements of the Central Bank. These will cover a range of areas including:
- asset size
 - ability to comply with enhanced governance, fitness and probity and risk management requirement
 - systems of control
 - organisation charts and details of responsibilities, skills, training and experience within the credit union
 - up-to-date policies and procedures covering all aspects of the credit union's business to include - liquidity, lending, investments, savings, operations and risk management
 - a detailed business plan which includes the projected impact of being admitted to another type on the credit union's financial position and liquidity position.
- 7.6.8 This offers a flexible approach to the regulation of credit unions and assists credit unions in determining the business model they wish to adopt going forward. It allows credit unions to continue to offer basic savings and loans but also allows other credit unions to develop and offer a greater range of services so long as they have the necessary scale and they comply with the additional requirements. Credit unions that

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wish to engage in additional services but are below the €100m threshold could merge with other credit unions in order to achieve the scale required.

7.7 Working as a movement

- 7.7.1 Most credit unions are members of a representative body – ILCU or CUDA. Much study has been done internationally, which can help provide an understanding of the rationale for, the dynamics involved within, and the advantages of being part of a well functioning representative body.
- 7.7.2 When a credit union movement is in its formative stage, the associated representative body is also in its infancy. At that juncture, one might expect the representative body to simply provide a ‘voice’ for member credit unions in, for example, dealings with regulators and legislators. As the credit union movement progresses, the representative body, as well as providing a ‘voice’, may also be increasingly required to provide ‘infrastructure’. This ‘infrastructure’ could be in terms of: products and services; education and training; and back-office facilities. It is at this latter stage that pressures within the representative body may emerge such that individual credit unions may feel they have more to gain from competition than cooperation.
- 7.7.3 A number of theoretical paradigms which can be subsumed under the broad heading of network theory help provide an understanding of representative bodies.
- 7.7.4 Das and Teng (2000) and McNamara (1999) outline resource-based and knowledge-based advantages of networks (representative bodies). Important elements here are the capital-raising options and the service-provision options within networks. Emphasis is placed on networks enabling members to engage in beneficial activities which would not have proved possible to do as single stand alone ventures. Olk and Elvera (2001) and BarNir and Smith (2002) detail the social and relational origins and benefits of networks. They argue networks confer friendship benefits, including emotional support, on participants. They also highlight the importance of trust, confidence, power and control as important in network situations.
- 7.7.5 Clarke-Hill et al. (2003) emphasise the paradox of competition and cooperation within networks. They believe that this paradox should not necessarily be viewed in negative terms, particularly if the network is sophisticated enough to manage the diverse interests of the members within the network to the mutual benefit of the network. Clark-Hill et al. (2003) also suggest that different, and at times opposing, positions and requirements may well be normal within networks. Neither should this be viewed as a weakness; rather it should be considered an objective of the network to manage the competing demands of members.
- 7.7.6 The survey findings highlighted that leadership at movement level is considered to be an important external constraint on development. It was argued that such a finding might be expected when set in the context of the frustration felt by credit unions about the many and varied challenges they currently face.
- 7.7.7 By analogy, if the sector is changing, then the role of trade representatives will need to change with it. The increased emphasis on credit union co-operation and shared services, as well as the need for increased skills and training, points to an obvious

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opportunity for credit unions to collaborate movement wide where this makes sense. In such a context, the benefits of representative body membership are maximised within a single trade association. More specifically, the benefits of representative body membership are maximised through common promotion of collectivist principles and with identifying generic strategies for the advancement of credit unions.

7.8 Common Bond

- 7.8.1 Credit unions cannot do business with the general public due to charter limitations based on serving a membership that is characterised by a common bond. The common bond is based on a pre-existing social connection, such as belonging to a particular community, industrial or geographic group.
- 7.8.2 A 'field of membership' approach to the common bond has been introduced in Great Britain and the United States. This allows credit unions to cater for members of different common bonds and bond types, i.e. have a number of different common bonds that are not connected. The bonds might be geographic, community, industrial, professional, etc. The credit union continues to operate the common bond principle in that each member must have one of the common bonds that are in the field of membership of the credit union.
- 7.8.3 In Great Britain, credit unions are now (post January 2012) to serve more than one group of people: They no longer have to prove that everyone who can join a credit union has something in common. A 'field of membership test' makes sure it is possible for all potential members to be served by the credit union. Credit unions whose 'common bond' includes a geographical area are limited to two million potential members. Where membership is over one million, however, the FSA treats the common bond as "meaningless". The change means that credit unions are able to provide services to different groups of people within one credit union. Credit unions are able to open up membership to new groups, such as tenants of a housing association or employees of a national company, even if some tenants/employees live outside the geographical area that the credit union serves.
- 7.8.4 In Great Britain, restrictions on non-qualifying members have also been removed. Similar to Ireland, people who move house or job and leave the 'common bond' of the credit union are classed as 'non-qualifying members'. The change will allow credit unions to set their own limits on these members.
- 7.8.5 In the consultation exercise carried out by the Commission, conflicting opinions were raised regarding the function of the common bond in the context of modern financial services systems. Some argued for its complete removal as it was considered obsolete. Others suggested it should remain, if not in its current form in some other form, to retain the sense of ownership and identity it brings.
- 7.8.6 The survey of credit unions reported that while attracting and retaining young members is important to all credit unions, it is particularly problematic for occupational credit unions. This may centre on the constraint placed on them by definition of their common bond.
- 7.8.7 Section 35(4) of the Credit Union Act 1997 requires that the total amount outstanding

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in respect of loans to non-qualifying members¹⁷ shall not exceed 10%, or such larger percentage as may be approved by the Central Bank, of the total amount outstanding in respect of all loans made by the credit union to its members. Credit unions report that this provision hinders them from issuing loans to long-standing members of good financial standing. This particularly applies to members who have moved residence a small distance outside the geographical area but continue to have a loyalty to their credit union.

7.9 Future developments

- 7.9.1 Under the restructuring process, it is envisaged that amalgamating credit unions will form a new credit union whose common bond comprises the constituent common bonds. For that reason, the Commission does not consider that the common bond presents an obstacle to restructuring.
- 7.9.2 The Government is to publish legislation establishing a statutory credit risk register in autumn 2012. A public consultation is planned; however the Bill is expected to include a requirement for all credit unions to access a central credit register to obtain the credit histories of their members and to update the register when issuing loans. The credit register will become an important tool in assisting credit unions assess creditworthiness and while familiarity with members through the common bond will continue to be an important tool also, credit unions will be less reliant on familiarity through the common bond. Credit unions will, of course, be expected to assess creditworthiness through their own regular in-house information management systems.

Recommendations on the common bond

- 7.9.3 The common bond is a fundamental characteristic of credit unions and the Commission envisages that credit union members will continue to have a strong sense of belonging to their credit union. The Commission expects that this sense of loyalty will continue to exist as part of the ethos of credit unions and it recommends that the common bond principle continues to be recognised in legislation. The Commission has considered the current operation of the common bond and the 'field of membership' approach adopted elsewhere. The Commission does not consider that a compelling case for fundamental change to the common bond has been made.
- 7.9.4 The Commission considers that the situation regarding non-qualifying members is unduly restrictive and recommends that the percentage of the loan book available for lending to non-qualifying members be decided by the board of directors of the credit union.

7.10 Additional services

- 7.10.1 All credit unions provide the basic savings and loan products. If a credit union wishes

¹⁷ Section 17(4) of the 1997 Act defines a 'non-qualifying' member as follows: (4) If a member of a credit union ceases to have the common bond required of members of that credit union, he may retain his membership and voting rights, and continue saving; but any such member (in this Act referred to as a "non-qualifying member") shall be left out of account in determining for any purpose whether a common bond exists between the members of the credit union.

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to provide a new additional service to its members, this needs to be agreed at a general meeting of members before applying to the Central Bank for permission. The Central Bank may approve the application if it is of the view that the service is of mutual benefit to the credit union members and if it is satisfied that the credit union has the skills and capacity to manage the provision of the service. It is important to note that the success of a credit union will not depend on it offering the services *it wants to offer*, but on offering the services *its members will want*. This points to the need for credit unions to market test and establish a clear business case before looking to expand services.

7.10.2 In cases where a service appears to the Central Bank to generally involve no risk to the assets of the credit union or the funds of its members, the Minister for Finance has powers to make regulations exempting such a service from the requirement to have the individual approval of the Central Bank. Those services currently exempted from requiring the express approval of the Central Bank before a credit union may offer the service are:

- Telephone, internet and fax access to the credit union by the member
- Third party payments
- Automated teller machine services (ATMs)
- Discount for goods and services
- Budget account scheme
- Bill payment services
- Euro drafts and bureau de change
- Money transfers
- Money Advice and Budgeting Service (MABS)
- Service centres
- Draws
- Standing orders
- Direct debits
- Financial counselling
- Will making
- Gift cheques
- Electricity budget meter cards or tokens, and
- Savings Stamps

and on an agency basis:

- Insurance services
- Group health insurance schemes and
- Personal Retirement Savings Accounts (PRSAs)

7.10.3 Credit unions are also required to meet all legislative and regulatory requirements in providing the above services; and any credit union considering providing new card services (such as ATM cards, Debit Cards, Prepaid Debit Cards) to its members is required to contact the Central Bank beforehand.

7.10.4 Notwithstanding that the legislation is intended to clear the way for individual credit unions to offer a wide range of services to their members, credit unions find the current procedure for approval of new additional services as slow and cumbersome. Some suggest that the requirement for a general meeting moves the decision-making

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away from the board and that it denies credit unions the ability to respond quickly in meeting new members' needs.

- 7.10.5 The August 2009 Amárach Research Report commissioned by the Irish League of Credit Unions indicated a wish by respondents, both members and non-members, for the following services to be available in their local credit union: insurance products, current accounts, debit cards, on-line banking and budgeting services. This suggests that not all credit unions are providing all approved services.
- 7.10.6 As part of the Commission survey, credit unions were asked to identify, to a maximum of four, new products and services which it is now important that the credit union provides to members. The question was open-ended in that respondents were not asked to choose from a prescribed range of products and services. Five product/service lines proved to be important to a substantive number of credit unions:
- debit/laser cards
 - online credit union services
 - Electronic Funds Transfer (EFT)
 - Automated Teller Machines (ATMs)
 - insurance products and services.
- 7.10.7 Many of these services, for example EFT, are already on offer by some credit unions but it is clear that there exists a latent demand by many others to enhance their existing product and service range.

Recommendations on additional services

- 7.10.8 The Commission does not consider it appropriate to specify which products and services credit unions ought/ought not to be able to provide. However, the US-related analysis in Chapter 6, International Perspectives, gives some indication of possible trends as the Irish credit union sector restructures. It shows that as credit union size increases the share of interest income from loans and investments declines (though still forming over 75% of income); fee income makes up about 10% of total income across size bands; and the contribution of other operating income steadily increases as credit union size increases.
- 7.10.9 The Commission recommends that a new regime for the provision of additional services should be developed within the context of the tiered regulatory approach as set out in greater detail earlier in this Chapter. Within this new regime, decisions to offer (or apply to offer) new services can be taken by the board of directors. It was suggested that the issue of additional services be designated a standing item on credit unions' AGM agendas which would provide an opportunity for a two way exchange of information on the issue, with the board reporting on any initiatives investigated or offered during the year while the membership could guide its directors to investigate or offer new services on their behalf.

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7.11 Providing services on a shared basis

- 7.11.1 The sharing of services offers credit unions an opportunity to benefit from economies of scale and allows them access to expertise credit unions may not normally have the resources to engage themselves. This may become increasingly important in the future given the increased complexity and running costs which would be expected from a modernised regulatory framework and enhanced service offering.
- 7.11.2 As set out in Chapter 6, services may be shared in a number of ways including the establishment of central credit unions, corporate credit unions, Credit Union Services Organisations (CUSOs), or local alliances. The survey undertaken by the Commission indicates that Irish credit unions appear to prefer services to be shared on a regional or local basis rather than through centrally operated facilities.
- 7.11.3 A number of shared service arrangements have developed within the Irish credit union movement; however this has not become a mainstream feature and has been limited in scope.
- 7.11.4 The analysis of the consultation responses and survey returns indicate that the sharing of services is seen as a critical element in the development of the credit union. There is strong demand for sharing the functions and services such as compliance, risk management, marketing and branding, debt collection, internal audit function and IT systems. Given the lack of appetite amongst credit unions for sharing of services on a centralised basis, regional alliances or CUSOs may be the more appropriate mechanisms for facilitating the sharing of services between credit unions in Ireland.
- 7.11.5 Sharing services may serve to build strong working relationships which may eventually lead to amalgamations of credit unions resulting in greater economies of scale and the opportunity to offer a broader range of services to members as a result of the increased scale of the merged entity. Conversely, setting up such shared services may also provide credit unions with an alternative to amalgamations while continuing to share services and maintaining strong relationships with other credit unions involved in the alliance or CUSO.
- 7.11.6 However, prior to engaging in alliances, credit unions should be aware of the risks involved, including potential losses on investment, and should be satisfied that the vehicle used to share services will be viable and will involve as little risk as possible to the credit unions. The establishment of CUSOs should be subject to safeguards such as limiting the services that can be offered and placing limits on investment in the CUSO. The issue of data protection will also need to be addressed by the participating credit unions.

Recommendation on shared services

- 7.11.7 While sharing services is to be encouraged as a mechanism for increasing economies of scale and promoting cooperation between credit unions, this should not expose the credit union to undue risk. The Commission recommends that the establishment of shared service arrangements should be facilitated, by legislation where necessary.

7.12 Information and Communications Technology

7.12.1 The evolution of credit unions' information and communications technology ("ICT") capability has not matched the pace at which such technology has impacted society generally. At credit union level:

- product delivery is almost 100% face-to-face,
- integration with the national payments system is limited,
- member-service ICT systems provide a basic capability to process core savings and loans and their capabilities generally restrain rather than enable product development,
- there are no common standards of development, processing, service or resilience for such systems,
- credit unions have limited capability to lead and manage ICT development, and
- the movement's confidence in its own ability to lead and develop such change is limited.

7.12.2 However, for credit unions to remain relevant to their actual and potential membership, and particularly a younger membership which expects a high degree of ICT sophistication, significant advances will be required. The financial service providers in the market – in Ireland and elsewhere – are also changing, with new entrants working to alternative business models now entering market segments where credit unions have been operating up to now. These alternative providers can offer a simple and customer-centric service to consumers. Furthermore, E-money and Payment Services regulation are making market entry easier for this type of service provider.

7.12.3 The introduction of a modern regulatory framework for credit unions will mean that credit unions will need to ensure they have in place effective systems, processes and controls to support their compliance with requirements. This places further demands on the ICT needs of credit unions.

7.12.4 The Commission received helpful presentations from key ICT stakeholders; however it found no single shared vision of how the above goals might be achieved. A core point to emerge however, is that defining a sustainable business model depends on knowing credit union members' and non-members' current needs. This must be clarified before operations, regulation and technology can be defined.

7.12.5 For the traditional credit union business model, existing systems may well be fit for purpose. For credit unions looking to develop a sustainable business model in a changing marketplace, then changes to ICT will be required, but it is unlikely there will be a single common solution. The future depends on the needs of members and non-members, and the requirements of a sustainable business model. However, ICT is only one of a number of tools to enable a sustainable business model and is not a simple solution for business problems in its own right.

Recommendations on Information and Communications Technology

7.12.6 The Commission is mindful that its recommendations should not be viewed as encouraging credit unions to undertake costly ICT investment for its own sake.

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- 7.12.7 The ICT needs of the sector are best defined at credit union or movement level rather than by government or the regulator, although systems will have to be capable of serving the needs of the regulatory system. It is the specific responsibility of each board of directors to ensure that ICT systems are fit for purpose and are capable of meeting regulatory requirements.
- 7.12.8 The ICT needs of credit unions are being driven by changing consumer preferences and increasing regulatory requirements in terms of systems and controls. Credit unions need to gain greater benefits from their investments in ICT by fully utilising existing systems to automate payments and expand the delivery channels and services available to members. Modern technology is already in place to support the businesses of the vast majority of credit unions, whether individually, in groups or collectively. Greater use of existing systems' features and an increase in electronic funds transfers could reduce costs and improve services. In particular, credit unions need to look at online banking and credit checking, become direct debit originators and opt for access to clearing where payments accounts are part of their business strategy.
- 7.12.9 The Commission acknowledges that many of the ICT challenges have been recognised by the credit union sector itself and that it has brought forward initiatives to improve the situation. ICT is recognised within the sector as a key facilitator for credit unions to provide products and services to members as well as providing the information required to ensure that credit unions are operating in a safe and sound manner. However, there remains a limited pool of in-house ICT expertise within credit unions, with few credit unions employing ICT personnel directly. It is important that credit unions ensure that their systems are fit for purpose and are operated in a safe and secure manner by people with the appropriate skills and expertise. Credit unions should have a sufficient grasp of ICT issues to make informed business decisions and to challenge professional advice. However, there is scope for better and closer co-operation and co-ordination among credit unions towards shared services and standardisation of processes, which could do a lot to reduce costs and improve efficiency.
- 7.12.10 While outsourcing and shared services may provide a way for credit unions to tap into existing skills and expertise outside the movement, there is still a need to ensure that core skills are available to credit unions to make informed business decisions, to project manage new initiatives and to challenge outside expert advice.

7.13 Financial Inclusion and Social Lending

- 7.13.1 Credit unions aim to provide for the economic and social goals of members and wider local communities. Credit unions are therefore in a position to play a key role in the provision of social lending and promoting financial inclusion.
- 7.13.2 Social lending involves loans to local enterprises and voluntary organisations to develop social infrastructures, with its purpose to provide affordable debt funding for community enterprises that can operate on a self-sustaining, commercial basis to create jobs, promote economic development, or otherwise improve social welfare. Social lending may be defined as *"the provision of low-cost credit, for primarily social as opposed to profit ends, to people who would otherwise have to use alternative (higher-*

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cost) *credit sources*¹⁸." In its deliberations, the Commission also included personal loans to those who are from disadvantaged backgrounds and are excluded from mainstream finance¹⁹.

- 7.13.3 Given that the credit union movement was born out of the principles of mutuality, self help and cooperation within the community, credit unions have traditionally played a central role in providing access to small emergency and budgeting loans to their members in Ireland. In a modernised credit union sector, the ethos of commitment to community will remain integral to the movement and in this context local credit unions may also be able to play an even more effective and enhanced role in the area of personal social lending which operates on the basis that what benefits one member of the community is to benefit the community as a whole.
- 7.13.4 Section 44 of the Credit Union Act 1997 provides that a credit union may, by resolution, establish a fund to be used for "such social, cultural or charitable purposes (including community development) as have been approved...". However, this fund may also be used to facilitate the provision of funds to low income groups. A review of Social Finance and the Credit Union Movement carried out in 2005 by the Credit Union Advisory Committee (CUAC), referred to a report of the ILCU *Prioritising Social Gain* which pointed out that the respondents to its questionnaire indicated that 10% of loans were dedicated to social finance provision, which included loans to low income consumers who had difficulty accessing credit elsewhere. In its considerations of Section 44 of the 1997 Act, the Report acknowledges that, while the fund can be used to "grant aid socially desirable products within the common bond area, the provision of such funding has been negligible".
- 7.13.5 St. Vincent de Paul and MABS have worked separately with the credit union movement to develop initiatives to provide lending to low income families. A number of local St Vincent de Paul and MABS services have worked closely with their local credit unions to establish "individual financial inclusion schemes" to assist people to borrow to cater for contingencies. Many credit unions hold "special accounts". This is a bill paying service operated in partnership between the client, the MABS and the credit union.²⁰ While there are some variations in the lending mechanisms put in place in different areas, the overall ethos of providing people with low cost emergency credit as an alternative to recourse to high cost money lenders has been the common thread.
- 7.13.6 The Commission supports the objectives of financial inclusion and the recommendation of the Steering Group on Financial Inclusion in its Strategy for Financial Inclusion Final Report, June 2011, for the provision of a Basic Payment Account (BPA) with consumers having the choice of selecting their service provider.

¹⁸ Definition provided by Dr. Stuart Stamp, Independent Social Researcher & Research Associate, Department of Applied Social Studies, NUI Maynooth, drawing on the work of Extortionate Credit in the UK: A report to the DTI By Elaine Kempson and Claire Whyley, June 1999

¹⁹ Financial Exclusion is defined by the European Commission as "a process whereby people encounter difficulties accessing and/or using financial services or products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong".

²⁰ For example, in the first half of 2011, 2,562 clients were actively engaging with their credit unions in respect of 3,214 debts to 244 credit unions through the Special Account facility. (Source: MABS Submission to Commission on Credit Unions, August 2011).

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- 7.13.7 A basic payment account could consist of the following functionalities: the opening and the closing of a payment account; the means for the consumer to receive, place, transfer and withdraw funds, both physically and electronically; the provision of a debit card allowing for the withdrawal of cash and the carrying out of electronic payments. However, an overdraft facility or overrunning would not be part of a basic payment account. Access to credit would not be considered as a component of or a right related to a basic payment account, whatever the purpose or the form of the credit.
- 7.13.8 A BPA is a payment account which has been designed to offer those functions which are essential in order to receive, place, transfer and withdraw funds, but does not have the full functionality of a current account (Steering Group on Financial Inclusion, 2011). At the current time, the banks are the logical providers of a BPA, as they are the only financial service institutions in the State with the necessary infrastructure in place at this point in time. However, this does not rule out other parties playing key roles, including credit unions.

Recommendations on Financial Inclusion and Social Lending

- 7.13.9 Credit unions should continue to co-operate with service providers such as St. Vincent de Paul and MABS. This joint working approach is likely to provide a good basis for the development of a wider model of social lending. Social inclusion lending schemes such as those which have been developed in the past between these Organisations and the credit union sector should be evaluated by the credit union movement to ensure that they are effective in reaching the identified target groups.
- 7.13.10 Their strong community roots and not-for-profit ethos also suggest that the BPA could be a good strategic fit for credit unions.
- 7.13.11 The role of credit unions in providing the BPA can be enhanced through access arrangements to bank service delivery infrastructure, thereby affording consumers the choice of where they open their account. While around 10% of credit unions have their own National Sort Code, a higher percentage currently facilitate incoming and outgoing payments, including social welfare payments and card based withdrawals, through a variety of arrangements. BNP Paribas and Bank of Ireland offer payment clearing arrangements to credit unions. The main issue for credit unions, and subsequently many consumers, is access to payments and bank infrastructure (e.g. ATM networks) and at a reasonable cost.
- 7.13.12 It is an opportune time to review how affordable access could be given to the financially excluded, directly or via their credit union or others.
- 7.13.13 Credit unions could take a more prominent role in developing and maintaining social inclusion lending schemes and play a major role in helping to develop a system of social finance. That role, however, needs to be carefully designed to integrate prudently with the basic credit union business of savings and lending services for individuals. Effective social finance is a specialised form of commercial lending that requires expertise which most credit unions do not possess. But what they do possess is the ability to mobilise the savings of their communities for socially desirable purposes.

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- 7.13.14 These schemes should be backed up with support mechanisms to facilitate credit unions becoming more actively involved in social lending. The Commission is of the view that there is a role here for each credit union and recommends that there also be a role for the representative bodies here. More specifically, the Commission makes the following recommendations on financial inclusion and social lending.

Specific recommendations on Financial Inclusion and Social Lending

- 7.13.15
1. That credit unions develop a specific policy on financial inclusion, consistent with Credit Union Operating Principle 7 (Service to members), Credit Union Operating Principle 8 (On-Going Education) and Credit Union Operating Principle 10 (Social Responsibility), and that they report annually to their members at AGM on their fulfilment of these obligations. Credit Unions Operating Principles are set out at Appendix 5.
 2. That credit unions allow for financial inclusion in their annual budgets and development plans to include access to credit for the financially disadvantaged.
 3. That credit unions engage with the voluntary and community sector to investigate possible common synergies and practical ways of promoting financial inclusion locally, including the development of specific services and products tailored to the needs of the lowest income groups.
 4. That credit unions reflect social inclusion planning in their risk management processes.
 5. That membership of the Implementation Group on Financial Inclusion is extended to the credit unions representative bodies.
 6. That the credit union movement collects aggregated information regarding the quantity of social lending within the movement on an annual basis.
 7. That a formal process of engagement be established between the credit union representative bodies and Government to determine safe ways to invest collective credit union funds into community projects, employment initiatives and small co-operatives.
 8. That credit unions be more pro-active in providing financial education and promoting positive money management habits. In order to encourage borrowers, a campaign should be undertaken in conjunction with the Citizens Information Board to educate consumers on accessing responsible credit alternatives, with targeted marketing campaigns for areas most associated with more expensive forms of borrowing.
 9. That evaluation should be a key component of social lending schemes to learn from the experiences of both using and administering social lending schemes, and ensure that they meet the objectives for which they were established.

GENERAL PRINCIPLE

Level of products and services to members increases

Increased scale, skills and competencies required

| Requirements | Type 1 Credit Unions | Type 2 Credit Unions | Type 3 Credit Unions |
|---|---|---|--|
| Illustrative Asset Bands | Assets <€10m | Assets >€10m <€100m | Assets > €100m |
| Governance & Risk Management | Minimum requirements in relation to Governance and Risk Management | Governance and Risk Management requirements including internal audit function, risk management and compliance officer. | Governance and Risk Management requirements that apply to Type 2 credit unions with dedicated internal audit, compliance and risk personnel and additional board committees. |
| Fitness & Probity | Minimum requirements (type of requirements to be considered in 2 nd Phase of implementation of Fitness & Probity Regime for credit unions). | Under 1 st Phase of Fitness & Probity Regime. <ul style="list-style-type: none"> Chair and Manager designated PCFs Additionally individuals performing roles: <ul style="list-style-type: none"> with significant influence involved in ensuring, controlling or monitoring compliance will be designated as CFs for credit unions (includes all board members). | Under 1 st Phase of Fitness & Probity Regime. As for Type 2 credit unions with additional PCFs: <ul style="list-style-type: none"> all additional board members the chair of the nomination committee the chair of the supervisory committee. |
| Reserves | Existing approach to apply. | Existing approach to apply. | Existing approach to apply/risk weighted approach if appropriate. |
| Liquidity | Existing approach to apply. | Existing approach to apply. | Existing approach to apply/more complex approach in line with business model of credit unions. |
| Lending | <ul style="list-style-type: none"> Maximum loan amount in excess of shares to be specified. Maximum loan term of 5 years. No business lending. | <ul style="list-style-type: none"> Existing maturity limits Changes include: Lending limits related to reserves. Limited business lending. | <ul style="list-style-type: none"> Existing maturity limits Changes include: Lending limits related to reserves. Less restrictive business lending than Type 2 credit unions. |
| Investments | <ul style="list-style-type: none"> Restricted to bank deposits. Maximum maturity 1 year. | <ul style="list-style-type: none"> Restricted to bank deposits & government bonds. Maximum maturity 5 years. | <ul style="list-style-type: none"> Wider range of assets e.g. bank bonds Longer maturities. |
| Savings | Limited to lower of specified % of assets and €50k. | Limited to lower of specified % of assets and €100k. | Limit based on specified % of assets. |
| Operations & Services | <ul style="list-style-type: none"> Focus on core savings & lending. Exempted additional services | <ul style="list-style-type: none"> Focus on core savings & lending. Exempted additional services Additional services subject to meeting specific requirements set by Central Bank or subject to prior approval from the Central Bank. Introduction of operational risk reserve requirement. | <ul style="list-style-type: none"> Savings & lending Exempted additional services Additional products /services subject to meeting specific requirements set by Central Bank. Certain products services may require Central Bank approval. Introduction of operational risk reserve requirement. |

Chapter 8 - Deposit Protection, Resolution, Stabilisation and Liquidity

8.1 Introduction

- 8.1.1 This Chapter sets out the recommendations of the Commission on Credit Unions with regard to designing a prudential management framework to underpin the future evolution of the sector having regard to its particular ethos and nature and to ensure a stable credit union sector.
- 8.1.2 A prudential management framework for credit unions can arguably be viewed as having a series of components^{xii}. These include:
- a) a regulatory framework (considered separately in Chapter 10) with a view to the protection by each credit union of the funds of its members and the maintenance of the financial stability and well-being of credit unions generally;
 - b) a deposit guarantee scheme to protect the savings of members up to a statutory maximum;
 - c) a resolution mechanism to deal with credit unions that are ‘not viable’;
 - d) stabilisation support, in certain circumstances and with conditions, for credit unions that are facing difficulties but are otherwise considered ‘viable’; and
 - e) a liquidity support mechanism to facilitate short-term liquidity needs for otherwise sound credit unions.^{xiii}
- 8.1.3 Deposit Guarantee Scheme, stabilisation and resolution should be handled in a coordinated, holistic fashion and controlled and governed by the Central Bank.
- 8.1.4 Ultimately, the objective of a prudential management framework must be the protection of the financial system (or group of organisations to which it applies) and not the individual entities within that system (or within the group).

8.2 Deposit Guarantee Scheme^{xiv}

- 8.2.1 Savings in credit unions are protected up to €100,000 per member per credit union by virtue of the Financial Services (Deposit Guarantee Scheme) Act 2009. The Commission recommends that credit unions remain subject to the general Deposit Guarantee Scheme rather than establishing a credit union-specific scheme.
- 8.2.2 In return for protection under the Deposit Guarantee Scheme, credit institutions must maintain a Deposit Protection Account at the Central Bank of such amount as may be

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determined by the Minister for Finance.^{xv} The provision that requires credit unions to maintain such an amount at the Central Bank has yet to be commenced. The Commission recommends that this provision be commenced for credit unions.

8.3 ‘Viable’ and ‘Not Viable’ Credit Unions

8.3.1 Within the credit union sector, it is critical that a distinction can be made between those credit unions that are ‘viable’ and those that are ‘not viable’.^{xvi}

8.3.2 When making a determination as to the viability of a credit union, the Commission recommends that a variety of interrelated factors should be taken into account. These factors should include capital adequacy, the dominant factor in determining the viability of a credit union^{xvii}, as well as, for example, factors relating to loan impairment and delinquency, investment impairment, high and rigid cost base, liquidity and the structure of liquidity, loan-to-asset ratio and governance capacity, and inability to present a feasible plan to restore capital reserves. The tendency for capital to lag behind other indicators of financial viability was noted.^{xviii}

8.3.3 While some members of the Commission emphasised the need to set out a range of factors related to the determination of viability, the Commission accepts that doing so must not impinge on the independence and ability of the Central Bank to take intervention actions in a credit union based on factors other than those general viability factors listed above at 8.3.2.

8.4 Resolution^{xix}

8.4.1 The development of a resolution regime for credit institutions has been the subject of detailed consideration both in Ireland and in the context of Ireland’s international relationships.

8.4.2 Resolution involves bringing, in this case a credit union, to an end of its life in an orderly manner, as provided for in the Central Bank and Credit Institutions (Resolution) Act 2011. The Commission recognises that circumstances may arise where liquidation takes place.

8.4.3 The Central Bank and Credit Institutions (Resolution) Act 2011^{xx} was passed into law in October 2011. Under the provisions of this Act, the assets and liabilities of a financial institution that is under a resolution process can be (1) transferred to another institution or (2) transferred on a temporary basis to a ‘bridge bank’ with a view to transferring them to another institution, or, (3) under Part 6 of the Act, a Special Manager may be appointed to manage that business or part of the business with a view to preserving or restoring the financial position of that credit institution, subsidiary or holding company, to wind down that business or part with a view to liquidating its assets and paying off its liabilities and shrinking its business to facilitate its possible liquidation or acquisition, or having regard to any recovery plan for, and any resolution plan for, that credit institution shall otherwise manage that business or part of the business; (4) liquidation; (5) recovery plans: the Act provides that having regard to the nature of the business of an authorised credit institution, the Bank may direct that credit institution to prepare a recovery plan setting out actions that could

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be taken to facilitate the continuation, or secure the business or part of the business, of that credit institution in a situation where the institution is experiencing financial instability. A recovery plan shall not assume that financial support will be available from the State or the Resolution Fund. The Bank may direct an authorised credit institution to implement its recovery plan, or any part of it, if the Bank is of the opinion that the actions contained in that plan or part are necessary or desirable. (6) Resolution plans: If the Bank has directed an authorised credit institution to prepare a recovery plan, the Central Bank may prepare a resolution plan for that credit institution. A resolution plan for an authorised credit institution is required to set out the Central Bank's preparations on a contingency basis for the exercise of the Central Bank's functions under this Act in relation to that credit institution. The Central Bank may direct an authorised credit institution to provide such information and analysis as the Bank requires for the preparation of a resolution plan.

8.4.4 These are in addition to powers in the Credit Union Act 1997 in relation to Administrators, Examiners and the winding up of a credit union.

8.4.5 In order for the Central Bank to use its powers to seek to make a proposed transfer order or a proposed special management order, the intervention conditions or grounds which are set out at Section 9 of the Central Bank and Credit Institutions (Resolution) Act 2011 must be met.^{xxi} The Commission recommends that the powers granted to the Central Bank under the Act, should be considered for those credit unions that meet the intervention conditions or grounds as set out in the Act. The Commission believes that a credit union that becomes, or is likely to become significantly undercapitalised or otherwise meets the conditions or grounds set out in the Act, as determined by the Central Bank in accordance with the specified criteria, and informed by international best practice (taking account of the significant differences in business models and support structures in other jurisdictions), should enter the resolution process if the conditions or grounds set out in the Act are met. This recommendation does not impact on the independence and ability of the Central Bank to use the resolution powers set out in the Act in any circumstances where the conditions or grounds set out in the Act are met. Although liquidation should take place only as a last resort, the Commission recognises that circumstances may arise which make it unavoidable.

8.4.6 A Resolution Fund was established under Section 10 of the Central Bank and Credit Institutions (Resolution) Act 2011 which is managed and administered by the Central Bank, to provide a source of funding for the resolution of financial instability in, or an imminent serious threat to the financial stability of, an authorised credit institution. The Commission notes that the Minister for Finance may, at the request of the Central Bank, provide a financial incentive to a credit union to accept the transfer of the assets and liabilities of another credit union. Any such financial incentive provided is a debt due and owing from the transferring credit union to the Credit Institutions Resolution Fund. Such funding provided by the Minister for Finance may be recovered, by the Minister, from the Credit Institutions Resolution Fund.

8.5 Steady-State Stabilisation

8.5.1 The Commission recommends that a steady-state stabilisation mechanism is established for individual credit unions and the credit union sector as a whole. It is the

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Commission's intention that the steady-state stabilisation mechanism apply in certain circumstances and under certain conditions for those credit unions that are facing difficulties but are otherwise considered by the Central Bank to be 'viable'.

- 8.5.2 In the course of its deliberations, a number of models for stabilisation were put forward by members of the Commission. These included the establishment of an independent statutory based, regulated Credit Union Stabilisation Company with a board of directors to include representatives of the credit union movement; the establishment of a Credit Union Stabilisation Fund with a board approved by the Minister for Finance; and the establishment of an Impaired Asset Agency with a board appointed by the Minister for Finance.
- 8.5.3 On balance, the Commission recommends that responsibility for stabilisation should rest with the Central Bank as the independent regulator for the sector and the entity with best access to information.
- 8.5.4 For a credit union identified by the Central Bank as 'viable' but not meeting regulatory requirements, intervention by the Central Bank is required. This might involve the Central Bank requiring the credit union to undertake certain measures to ensure compliance.
- 8.5.5 For a credit union identified by the Central Bank as 'viable' but undercapitalised, the Central Bank may decide that in addition to the undertaking of specified actions to ensure compliance, financial stabilisation assistance is also required and warranted.
- 8.5.6 The Commission recommends that the stabilisation actions carried out by the Central Bank will include, among other things, such actions as:
- The provision of technical and financial advice;
 - Mandatory changes to governance structures of the credit union;
 - Changes to the business, operations, systems and processes within the credit union;
 - Capitalisation of the credit union.
- 8.5.7 On entering a stabilisation process, the credit union will provide the Central Bank with, among other things:
- a plan setting out quarterly targets for the credit union to return to a status of 'viable', as determined by the criteria set out by the Central Bank, at the end of the stabilisation process,
 - quarterly reports indicating that the agreed targets have been achieved, and
 - any other reports or inspections as requested by the Central Bank.
- 8.5.8 The Commission recommends that a statutory fund, to be controlled and governed by the Central Bank, is established to finance stabilisation actions and that the necessary financing of that fund be sourced from the credit union sector.^{xxii xxiii} The Commission also recommends that the provision of any funding from this fund to a credit union is wholly dependent on that credit union's compliance with stated terms.
- 8.5.9 The Commission recognises that there is a risk that some credit unions may seek to continue in a stabilisation process for a prolonged period of time. To remove this risk,

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the Commission recommends that the stabilisation process be time limited, that is, it lasts for a specific period of time after which the credit union is either determined to be viable (meeting all regulatory requirements and no longer requiring intervention by the Central Bank) or the credit union enters the resolution process. In the case of a credit union that fails to comply with the conditions of the stabilisation process or any instructions issued by the Central Bank as part of the stabilisation process, that credit union should enter the resolution process^{xxiv}.

- 8.5.10 In making this recommendation, the Commission is aware that the European Commission may be concerned about the application of state aid rules. The Commission recommends that clarity should be sought from the European Commission in relation to any potential state aid concerns and it should be made clear to the European Commission that its recommendation is what it believes to be in the best interests of the credit union sector in Ireland and how best to develop the sector.
- 8.5.11 The Commission recommends that the Credit Union Act 1997 be amended to allow for the establishment of a credit union stabilisation oversight committee. It is the intention of the Commission that such a committee will focus on how the Central Bank has implemented its own rules and procedures in making stabilisation decisions and taking stabilisation actions and that the committee will report its conclusions to the Minister for Finance and the Governor of the Central Bank. The work of the committee will focus on those decisions that have been taken and the committee will not in any way interfere with the independent authority of the Central Bank to act as it sees fit within the statutory framework. The Commission recommends that the Minister for Finance appoint seven people to the committee taking cognisance of the representative nature of the appointees, the volunteer ethos of the sector and the representative bodies.

8.6 Liquidity

- 8.6.1 Liquidity pressures on credit unions have eased somewhat since the last review of liquidity in 2009. This is in part due to work done by credit unions with the Central Bank to improve liquidity levels, which now stand well above minimum requirements (average liquidity currently stands at 47.38%). It appears that – coupled with the liquidity controls already in place – a simple mechanism, with a straight-forward administrative structure may be the way forward.
- 8.6.2 There have been some limited bilateral liquidity arrangements between Irish credit unions, but on a small scale. The complex issues involved in providing bilateral liquidity, including assessment of collateral and risk management, suggest that this option offers only limited scope for providing sector-wide liquidity.
- 8.6.3 While credit unions are eligible for participation in Eurosystem monetary operations, the expertise, systems and collateral requirements involved effectively rule out this avenue as a viable option for most credit unions.
- 8.6.4 As noted in Chapter 3, liquidity shortfall is not a pressing matter for most credit unions, indeed the problem for many now appears to be one of excessive liquidity holdings. The Commission does not consider that there is a compelling need to establish a central liquidity mechanism at this time.

Chapter 9 – Sector Restructuring

9.1 Introduction

- 9.1.1 In simple terms, restructuring would involve moving from a situation where over 400 credit unions operate and act independently, to one where there is some consolidation through amalgamations and the development of close networks and shared services.
- 9.1.2 Restructuring can be viewed in two ways:
1. As a way of addressing the current weaknesses in the sector
 2. As a business strategy for credit unions that want to achieve the scale necessary to move to a more efficient and sophisticated business model
- 9.1.3 Restructuring will not apply to all credit unions. Some credit unions will continue to operate successfully on a stand-alone basis should they so choose. In proposing reforms, it is important not to overlook the strengths of the sector which have helped it to grow and sustain itself for many years.
- 9.1.4 Transfer orders, in particular, would see the assets and liabilities of weaker credit unions transferring to stronger ones and this will bring about a degree of restructuring. The Interim Report of the Commission has already recommended that these resolution powers ought to be used for non-viable credit unions where the provisions of the Central Bank and Credit Institutions (Resolution) Act 2011 are satisfied. The Commission is of the view that resolution can serve a useful purpose by dealing with non-viable credit unions before they can pose a risk to their members and the wider movement.
- 9.1.5 In terms of stabilisation, the Commission has recommended that a steady-state stabilisation mechanism is established for individual credit unions and the credit union sector as a whole. Stabilisation is to apply in certain circumstances and under certain conditions for those credit unions that are facing difficulties but are otherwise considered by the Central Bank to be ‘viable’.
- 9.1.6 To avoid any conflicts or overlaps during the restructuring process, the Commission recommends that stabilisation strictly be used to address short-term problems at credit unions that are viable but undercapitalised (reserves above 7.5%). Stabilisation should not be used to address underlying structural problems with credit unions that ought to be addressed more appropriately through restructuring or resolution.
- 9.1.7 In terms of business strategy, the tiered regulatory approach provides an incentive for credit unions to consider restructuring where to do so would bring them into the upper tiers where the scope for additional services (and the associated additional income), lending and investments is wider. Restructuring could also bring the economies of scale needed to address recent increases in costs and to make the necessary investments in skills, technology and systems more affordable.

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9.2 Viability

9.2.1 The Interim Report recommended that a variety of interrelated factors should be taken into account when assessing viability. These factors include capital adequacy as the key indicator, and in general:

1. Where the assessment indicates the capital shortfall will result in a regulatory reserve ratio above 7.5%, the credit union will be directed to make up the capital shortfall ensuring that the credit union's reserves return to the regulatory reserve requirement. The credit union must demonstrate that this can be achieved within an appropriate time-frame.
2. Where a credit union's regulatory reserve ratio falls below 7.5% the credit union should be considered for the resolution process.

9.2.2 Clearly, other factors are important also: loan impairment and delinquency, investment impairment, high and rigid cost base, liquidity and the structure of liquidity, loan-to-asset ratio and governance capacity, and inability to present a feasible plan to restore capital reserves.

9.2.3 The Commission has explored several possible approaches to viability, accepting that no one metric is perfect and that there will always be a place for discretion and judgment in any assessment. In addition to models put forward by Commission members, the Commission also looked at the PEARLS monitoring system advocated by WOCCU and the CAMELS system used in many countries including the US for both banks and credit unions.

9.2.4 It is the Commission's view that the CAMELS system^{xxv} is preferable as a way of assessing viability. It is a tried and tested mechanism internationally which draws from prudential returns and on-site monitoring. Furthermore, it offers a ready way of thinking about viability as both an holistic concept and a relative assessment framework. However, for the purposes of informing future decisions about credit unions, CAMELS needs to be augmented with forward looking analysis, based on a PCAR and other metrics.

9.2.5 In its Interim Report, the Commission considered the central importance of viability in the context of both resolution and stabilisation. The Interim Report recommended that non-viable credit unions should be considered for resolution in the event that they meet the intervention conditions or grounds set out in the Central Bank and Credit Institutions (Resolution) Act 2011. The Commission is of the view that restructuring should not be used as a way of 'rescuing' failed credit unions that ought to be resolved.

9.3 Credit union efficiency

9.3.1 To inform the work of the Commission, an assessment of the relative performance of Irish credit unions was undertaken. The analysis was based on annual financial information for each credit union between 2002 and 2010, (full document attached in

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Appendix 4).²¹ It indicates that there is a variation in performance in the sector and that larger and better capitalised credit unions are better performers in efficiency terms.

- 9.3.2 The modelling approach considers each credit union as using capital expenditure, salaries and pension contributions, and interest paid on deposits and dividends paid on shares to produce *desirable* outputs that is loans, cash and investments and shares and deposits. The modelling approach also recognises that in producing these *desirable* outputs some *undesirable* by-products result, notably loans and investments which go wrong and may be written off.
- 9.3.3 The model produces a performance score for each credit union ranging from 1 (highly efficient in transforming inputs into outputs) to 0 (highly inefficient in transforming inputs into outputs).
- 9.3.4 The analysis then asks the question, if under performing credit unions were in a position to emulate those credit unions identified as most efficient to what extent would their performance improve? The average performance score was 0.73. This implies that if the 'average' credit union were able to put in place the systems and structures of the best performing credit unions then that average credit union would be in a position to expand its *desirable* outputs by 37% ($1/0.73 = 1.37$), while simultaneously contracting its *undesirable* output by 27% ($1 - 0.73 = 0.27$).
- 9.3.5 The analysis then explores why credit unions differ in terms of their level of performance. A number of factors are identified as statistically influencing performance differences.
- 9.3.6 Firstly, common bond type was identified as important with occupational/associational credit unions performing better than community credit unions. The better performance of occupational/associational credit unions may in part be influenced by the fact that the majority of their members are in salaried employment, whereas community credit unions may have a proportion of unemployed members. For certain occupational/associational credit unions, there may also be some hidden *in kind* advantage, for example many occupational/associational credit unions operate direct payroll deduction of loan repayments which may help in reducing loan delinquency.
- 9.3.7 Secondly, as credit unions increase in size this is associated with an improvement in performance. In exploring the relationship between size and performance further, the key result to emerge was that credit unions with assets in excess of €100m are much more efficient than those in other asset size categories (less than €20 million, €20million to €40million, €40 million to €60million, €60 million to €100 million).
- 9.3.8 Thirdly, better capitalised credit unions were identified as better performing. In investigating this finding further, it was observed that those credit unions meeting their regulatory capital requirement (8% capital ratio prior to 2008 and 10% capital ratio after 2008) were more efficient than those credit unions which did not meet the regulatory requirement.

²¹ A Performance Overview of Irish Credit Unions – Professor Donal G. McKillop and Barry Quinn (2012).

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- 9.3.9 Fourthly, credit unions which had higher levels of liquidity were shown to perform better than those with lower levels of liquidity.
- 9.3.10 Over the period 2002 to 2010, the analysis also identified that there was a reduction in average performance scores. To explore further, performance scores were analysed over three distinct time frames 2002-2004, 2005-2007 and 2008-2010. The analysis finds broadly similar levels of performance in the periods 2002-2004 and 2005-2007 but that average performance deteriorated significantly in the 2008-2010 period, a result not unexpected given the adverse economic conditions post-2007.
- 9.3.11 The study also highlighted that 44% of credit unions faced an added ‘opportunity cost’ in trying to reduce levels of bad debt. This suggests that these credit unions face an opportunity cost, in terms of lower production of *desirable* outputs and/or higher input requirements, as they divert input resources to help minimise bad debt problems.

9.4 Models for restructuring

- 9.4.1 In the course of its deliberations, a number of models for a restructured sector were discussed by the Commission, which are discussed elsewhere in this Report and are further elaborated upon below.

Atomised model

- 9.4.2 This model exists in the United States, Canada, Australia and the UK which have experienced orderly and evolutionary resolution and rationalisation on a consistent basis, as required, over a period of time.
- 9.4.3 Resolution of credit unions in this case could include a system similar to the purchase and assumption model in the United States whereby a special manager is appointed to the failed credit union, the assets of the credit union (discounted to market value) are transferred to a receiving credit union and any residual parts of the credit union (possibly premises, remaining loans) etc. are left to be wound-down/sold by the Regulator²².
- 9.4.4 This model further proposes the creation of a bridge bank on a temporary basis to take on the assets of a credit union that are not wanted by a transferee credit union or to take on a credit union for which no suitable transferee credit union would be willing to take on the engagements of the failed credit union.
- 9.4.5 A risk based net worth requirement was also put in place for complex credit unions. Credit unions classified as well capitalised or adequately capitalised are free from supervisory interference under the PCA system. Credit unions classified as undercapitalised or below are required to take progressively more radical steps to restore net worth to adequate levels.
- 9.4.6 The obvious advantage to this model from a credit union’s point of view is that it is bottom-up and sector-led. It allows credit unions to solve their own problems at a

²² This has many similarities to the transfer order process under the Central Bank and Credit Institutions (Resolution) Act 2011.

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manageable, yet appropriate, pace. It would also allow credit unions to draw on a wealth of international experience. Furthermore, it avoids the introduction of schemes that may be ultimately undeliverable. The use of assisted mergers and CUSOs could still bring about change to the sector, without intrusive regulatory or policy intervention.

- 9.4.7 The scale and pace of credit union consolidation in Ireland to date suggests that voluntary restructuring without support is unlikely to bring about the extent of restructuring that may be necessary to resolve the very real problems facing some credit unions. The Commission also acknowledges that resolution – including the transfer process – and voluntary consolidation should remain important elements of the overall approach to restructuring.

Strategic Groupings

- 9.4.8 This would involve the planned voluntary merger of two or more credit unions to form one single legal entity which would operate local offices. This proposal would allow for the provision of a full range of member services through shared services, the establishment of Credit Union Service Organisations (CUSOs) and movement owned entities.
- 9.4.9 The decision to restructure under this proposal would be a voluntary one and would not be directed. It is envisaged that struggling credit unions would be enticed into a merger or transfer due to the increased services that could be offered to members, the increased financial strength which would result from the merger and the transfer of the regulatory compliance burden to the main office.
- 9.4.10 An advantage of this approach is that it preserves the democratic structure of credit unions, while also allowing for closer collaboration based on shared interests. Secondly, it allows for cross-capitalisation, whereby strong credit unions merge with weaker ones, which would reduce the cost burden. Furthermore, it would allow the Irish approach to draw on a wealth of international experience regarding CUSOs and other shared arrangements.
- 9.4.11 The disadvantage of this approach is that its voluntary nature may mean that it has insufficient momentum to bring about restructuring on the scale required. The level of consensus required may not be achievable on a wider scale and may take too long. Secondly, the weakest credit unions may not be able to find suitable partners and the most difficult problems in the sector may not be addressed under this model. Thirdly, directors have a duty to protect the interest of their members, and this may be an issue if cross capitalisation\cross guarantees are required.

Regional Credit Unions

- 9.4.12 This model would involve adapting the resolution regime to allow for the involvement of special managers in the restructuring process in a more overt way, for example to direct or facilitate the establishment of regional credit unions to direct transfers. It would involve the establishment of regional credit unions that would operate a number of sub-office credit unions in a region. Regional credit unions would be strengthened both financially and operationally to allow them to take on other weak credit unions. This would be achieved by the appointment of a special manager and

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the provision of financial support. Key decisions would be made at regional level with policies and procedures set by that entity implemented in each local office. The regulatory compliance burden would also rest with the regional entity. Once the appropriate structures and systems have been put in place, the special manager would then be withdrawn and control of the entity transferred into the hands of the members.

- 9.4.13 This model has a number of advantages. First, it would obviate the need to liquidate entities arising from the lack of suitable transferees, if this is proven to be the case. Second, it would seek to retain a local presence so that the community connection to local offices would be preserved where possible. Third, it facilitates the use of special manager expertise to oversee transfers in a coherent way and allows the process to be underpinned and managed by skilled professionals. Fourth, it provides the mechanism for regulatory and governance changes to bed down during the restructuring process.
- 9.4.14 However, the Commission did also consider a number of possible difficulties with the proposal. This approach would involve top-down direction of restructuring in the sector which may not be consistent with the community-based ethos of the sector. Furthermore, this type of intervention is untried in other international jurisdictions.

Federated Model

- 9.4.15 This proposal would involve establishing a local federated structure operating along county or sub-county lines that would be phased in over a period of 4-5 years. Every credit union would become part of the local federation which would be regulated by the Central Bank. In contrast to the foregoing proposals, this would be a one size fits all model whereby all credit unions would be compelled to form part of the federated structure.
- 9.4.16 The powers, functions and responsibilities of the local boards would be transferred to the Federation on a planned, phased basis allowing for a transition period up to five years. A three, four or five year plan would be adopted to achieve certain milestones within a certain period of time, eventually leading to complete transfer of powers and functions to the Federation.
- 9.4.17 This proposal would allow for the resolution of a failing or failed credit union within the transition period to ensure that it would not adversely impact the Federation as a whole.
- 9.4.18 The Federated model has a number of advantages. It provides a clear road map for credit unions over the medium term. Secondly, it provides for a stable transition, with incremental progress towards the restructured state. Thirdly, by using a county basis it draws on existing community identities and attachments.
- 9.4.19 There are however, some possible difficulties with this approach. Firstly, it is somewhat inflexible and leaves little discretion for credit unions to shape their own future or to devise alternative, bespoke arrangements to suit local circumstances. Secondly, it may require tight direction and oversight which may become unmanageable if done sector-wide. Thirdly, it is, by definition, a one-size-fits-all and envisages a degree of standardisation which may not be achievable in practice.

9.5 Commission's conclusions on restructuring

9.5.1 The Commission is united on the guiding aims of restructuring:

- the protection of credit union members' savings;
- the stability and viability of credit unions and the sector at large; and
- the preservation of the credit union identity and ethos.

9.5.2 The objective of the restructuring process is to provide the opportunity to stronger credit unions to develop a more sophisticated – and ultimately more sustainable – business model and provide a mechanism to sort through the financial stresses in the sector in an orderly way.

9.5.3 In the absence of a policy intervention to restructure credit unions, there is the risk that problems will unwind over an extended period and in a way that erodes member and public confidence in the sector and which increases the risk of costly resolutions and liquidations.

9.5.4 As Chapter 7 entitled, 'Future Models of Credit Unions' explains, credit unions could find themselves limited by a high-cost operating model that dulls their competitive edge and constrains their business with little prospect of building the economies of scale and scope that would enable them to meet member needs over the medium term. The tiered regulatory environment also provides an opportunity for credit unions to restructure as a way of attaining a more sophisticated business model.

9.6 Commission on Credit Unions Recommendations on Credit Union Restructuring:

Principles, approach and benefits

- 9.6.1
- The primary focus should be on using stronger credit unions to anchor restructuring with other participating credit unions to fulfil current and future members' needs.
 - The restructuring process should be incentivised, time-bound and voluntary.
 - It would offer a path to sustainability for those credit unions that would not otherwise be capable of independent viability. However, restructuring must not impinge on the Central Bank's independence or resolution actions.
 - The focus should be on bringing stability to the credit union system overall, without impinging on the ability of some credit unions to succeed on a stand-alone basis.
 - Incentivisation will not work on its own: a catalyst for restructuring is needed to facilitate and provide the necessary skills and technical supports to make it happen.
 - Restructuring should be carried out according to a clear and time-bound plan.

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- Restructuring will need to be incentivised in a way that uses funding most efficiently, draws on any available excess capital within the participating credit unions and mitigates State aid issues.

9.6.2 Based on these principles, the Commission recommends the approach to restructuring set out below.

- A new body should be established on a short-term basis – called the Credit Union Restructuring Board (hereinafter the ReBo) to engage with credit unions on the ground and facilitate the restructuring process.
- An assessment of all credit unions will be undertaken against objective criteria in a way that is also forward-looking.
- The ReBo shall plan for restructuring and engage with credit unions.
- Where restructuring is proposed via the ReBo, a plan must be prepared with the help of the ReBo which sets out all the details of the proposed restructuring, including any funding needed to restore or ensure adequate reserve levels and update systems.
- Restructuring proposals will need the endorsement of the ReBo board before going to the Central Bank for consideration for regulatory approval.
- Exchequer funding will be made available to support the process. This will be recoupable, but in a way that will not act as a drag on the restructuring process.
- This process will be time bound, with a window of 4 years for restructuring to take place.
- It will be open to credit unions to opt-out of the process where they are in a position to operate in an independently viable way.

9.6.3 The Commission considers that there are a number of benefits to the new restructured entity, and to the credit union sector, of this approach to restructuring:

Credit union advantages:

- It will receive funding to strengthen its balance sheet, thereby mitigating the risks that could otherwise be presented by an amalgamation.
- The credit unions concerned will become part of a larger entity with a strong balance sheet and viable business model.
- It will benefit from an expanded common bond.
- It will benefit from economies of scope and scale.
- It will be better placed to achieve the scale necessary to expand its range of services.

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- It will be able to upgrade its ICT and other systems with the benefit of professional expertise and advice.
- It will have access to a wider pool of skilled volunteers.

Sector advantages:

- It will provide a once-off opportunity to put the sector on a sounder footing.
- It will contribute to stability in the sector overall.
- There will be an improved 'credit union' brand image.
- It will allow for enhanced opportunities for amalgamations and networks into the future.
- It will facilitate a more coherent and planned mechanism for voluntary restructuring.
- It will increase the potential for enhanced scale and scope of services to members.

- 9.6.4 From the point of view of the public interest, restructuring will help to bring stability to the credit union sector and the financial system overall and enhance public confidence in the sector. It also avoids the destabilising effects of the problems in credit unions unravelling in a costly and drawn-out way over a long period of time. Where State funding is involved, it is being provided in the expectation of a return for the taxpayer pending repayment of the principal.

9.7 Step 1: Engaging with credit unions

- 9.7.1 Each credit union will have the opportunity to engage with the ReBo. For the most part, this engagement will involve a preliminary discussion on restructuring options open to that credit union, based on available information provided by the Central Bank. The sharing of this information by the Central Bank may need to be enabled by legislation. While this information will not form the sole basis for decision making, it will provide enough to allow the engagement with credit unions to begin. It will be necessary to have more detailed analysis done at the next stage. This next stage would involve those credit unions who have expressed an interest in restructuring or where the ReBo is proactive in identifying viable prospects for restructuring. The more detailed analysis will need to have a forward-looking element to allow an assessment of how the credit union is likely to fare over the coming years. At the end of this process, credit unions should be assessed as capable of anchoring a restructuring proposal; capable of becoming a participating credit union in a restructuring proposal; or capable of independent viability into the future but not capable of anchoring a restructuring proposal.
- 9.7.2 It is important that these assessments have the confidence of the Central Bank and are seen as balanced and credible across the sector. It is also important that the assessments are completed within a short timeframe, given that the restructuring

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process cannot begin in earnest without them.

- 9.7.3 The Commission believes that this process should be transparent and that full information should be available to each credit union on how it is scored across the criteria and how the scores were arrived at. It will also be important that the information is prepared in a consistent way so that credit unions considering restructuring can make an informed decision about the other entities they are restructuring with.
- 9.7.4 In some cases, distressed credit unions may still form part of a timely restructuring proposal where the proposal is successful in securing ReBo, Central Bank and funding approval. However, the legislation underpinning restructuring should make it clear that the restructuring process should not cut across the ability of the Central Bank to take resolution action under the Central Bank and Credit Institutions (Resolution) Act 2011, where necessary.

9.8 Step 2: Making it happen

- 9.8.1 The ReBo will be established as a short-term body to facilitate and support the restructuring process. Its role will be to engage with credit unions on the ground in order to bring forward credible restructuring proposals which can form the basis for a coherent and orderly process, subject to regulatory and (where necessary) funding approval. It will not have a supervisory or regulatory role, this being the responsibility of the Central Bank. Its role will be to:
- Consider the information provided to it by the Central Bank with a view to planning for and encouraging restructuring where it considers that to be both necessary and appropriate.
 - Engage with credit unions on the ground with a view to formulating restructuring proposals for submission to the Central Bank and (where necessary) for funding approval.
 - Provide technical support and expertise for restructuring proposals; project manage the restructuring process; and provide post-restructuring support.
 - Provide the primary interface with the Central Bank on restructuring proposals.
- 9.8.2 It should operate by engaging directly with credit unions on the ground wherever possible to facilitate agreement on restructuring proposals. The ReBo should operate on a low-cost model to reflect its short-term and focused remit.
- 9.8.3 The work of the ReBo should be overseen by a board appointed by the Minister for Finance including members from Government, the Central Bank, credit unions, representative bodies, other credit union stakeholders and independent members.
- 9.8.4 In addition to its oversight role, the ReBo board will be responsible for recommending restructuring proposals for submission to the Central Bank.
- 9.8.5 The Commission recommends that restructuring takes place on a time bound basis and that it is not open-ended. Therefore, the ReBo should be established for a limited period not exceeding four years to ensure that restructuring takes place within a set window.

- 9.8.6 The ReBo should be established as soon as possible and on a statutory basis, only where that is necessary to provide for the necessary operational and budgetary arrangements. The ReBo should be established on an administrative basis in the meantime to ensure that commencement of restructuring is not delayed by enactment of the necessary legislation. Any statutory provision should ensure no conflict or overlap between the functions of the ReBo and those of the Central Bank. The ReBo should be funded²³ jointly by the State and the sector, as per the current model for funding the regulatory functions of the Central Bank.

9.9 Step 3: Formulating restructuring proposals

- 9.9.1 From an operational standpoint, the ReBo will engage with credit unions on the ground through coordinators. The ReBo coordinators will take as a starting point the assessment of credit unions.
- 9.9.2 In the case of credit unions anchoring the restructuring proposal, the ReBo coordinator should undertake intensive business analysis to examine improvements to systems, controls, governance and to address any potentially destabilising financial weaknesses, for example inadequate provisions, liquidity or reserves.
- 9.9.3 The ReBo coordinator will undertake a similar analysis of the other participating credit unions, for the purpose of examining systems, controls, etc. The ReBo coordinator will also prepare transition and post-restructuring plans with a view to minimising disruption during and after the restructuring. A clear communication plan will be needed also to ensure that members and other stakeholders have ready access to clear information at any given point in the process. The objective of this exercise is to formulate a restructuring proposal which identifies the funding needed and the changes required to systems, controls, governance, etc. to deliver a stable restructuring proposal.

9.10 Approval of proposals²⁴

- 9.10.1 Restructuring proposals will need the endorsement of the ReBo before going to the Central Bank for regulatory approval.
- 9.10.2 The ReBo will have a regular interface with the Central Bank in making proposals, receiving feedback and preparing iterative versions of the proposal. Changes to the proposal will need the support of the participating credit unions and so their involvement in the process will be important also.

²³ This refers to running costs rather than other restructuring costs.

²⁴ Funding approval dealt with separately below.

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9.11 Provision of funding

- 9.11.1 The Commission expects that funding will be required to bring about restructuring. The potential sources of funding are:
- any available excess capital within the participating credit unions
 - the credit union sector
 - Exchequer advances
- 9.11.2 The amount of funding required will not be known until the credit union assessments have been completed. It is envisaged that a significant funding requirement will be needed.
- 9.11.3 Funding will be needed to ensure that the restructured credit union has sufficient financial resources to remain stable and independently viable into the future. Further support may be needed to upgrade systems and controls; provide technical assistance; and to provide post-restructuring support. Funding will be conditional on the restructuring and on delivery of and compliance with the restructuring plan.
- 9.11.4 It will be important that sector resources are not drawn upon to the extent that the cost of restructuring is destabilising. At the same time, Exchequer resources are scarce and it is important to avoid moral hazard and State aid issues.
- 9.11.5 On that basis, the Commission proposes that restructuring should be funded as follows:
- The first call should be on any available excess capital within the participating credit unions
 - The affordability of sector-wide contributions should be assessed. This assessment should have regard to the cost of existing and impending levies on the credit union sector for regulation, resolution, stabilisation, etc.
 - Exchequer funding should be provided on a recoupable basis, as set out below.
- 9.11.6 In providing Exchequer funding, it will be important to avoid distortions of competition that could give rise to State aid issues, and to ensure that scarce resources are used efficiently and avoid moral hazard.
- 9.11.7 Where funding is to count as part of reserves, it must be realised, unrestricted and non-distributable. This is to ensure that it is capable of absorbing losses.
- 9.11.8 However, the Commission expects that restructured credit unions will go on to achieve independent viability to the extent that they will be capable of generating sufficient earnings to build-up reserves and pay a dividend. For that reason the Commission recommends that any State funding be made recoupable over the medium term – either from the credit union concerned, the sector, or both – and structured so as to avoid acting as a drag on credit unions' path to independent viability.
- 9.11.9 As stated above, it is recommended that restructuring proposals would need Central Bank approval. Where funding is involved, it is recommended that restructuring

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proposals would also need the endorsement of the ReBo board before being submitted to the Minister for Finance for final approval. The Minister may wish to consider appropriate approval and payment mechanisms for any State funding.

9.12 Timeline

9.12.1 The Commission considers that the restructuring process should take place within a clear timeframe to ensure problems are dealt with promptly and that any instability brought about during the transition process is minimised.

9.12.2 The following indicative timescale is proposed by the Commission (some proposals may progress more quickly than this):

Q2 2012

Establishment of ReBo board (The Commission recommends that this is done as soon as possible)

Q3 – Q4 2012

Operationalise ReBo and undertake preliminary engagement with credit unions

Q1 2013

Full engagement between ReBo and credit unions to formulate restructuring proposals

Q2 2013

Submission of restructuring proposals for approval by ReBo, Central Bank and for funding approval.

Q3 2013

Completion of approval process

Q4 2013

Restructuring ongoing

Q4 2014

Restructuring complete; post restructuring support

Q4 2015

End of post-restructuring support

9.13 State aid issues

9.13.1 In advance of putting in place any restructuring of credit unions, it will be necessary for Ireland to submit a State aid notification to the EU Commission for approval. The Commission on Credit Unions has given careful consideration to the possible State aid dimensions to its restructuring proposals. The Commission is very much aware of the need to mitigate any State aid issues in restructuring but is also of the view that it will not be possible to bring stability to the sector through restructuring by letting market forces operate alone. The Commission on Credit unions believes that the following

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features of restructuring will work to mitigate any State issues:

- the focus is on building-up stronger credit unions, so restructuring will not reward failure
- the use of the excess capital in the sector allows private sector solutions to be used in the first instance
- the mechanism for injecting exchequer funding provides for a dividend and for repayment of the principal in a way that mitigates moral hazard and acts as a brake on the credit union concerned profiting unduly from State support.

9.13.2 In the case of resolution via transfers under the Central Bank and Credit Institutions (Resolution) Act 2011, there is provision for a competitive process when transferring a credit union. This is an important design feature of that regime to ensure its consistency with State aid requirements. The Commission on Credit Unions recommends that a competitive process form part of the restructuring programme to ensure consistency with State aid requirements.

Chapter 10 – Legislation and Regulation of Credit Unions

10.1 Introduction

- 10.1.1 Credit unions are private organisations owned by their members but because they provide financial services it is appropriate that they are regulated. The State should operate a strong system of oversight that maintains the safety and soundness of the sector and that protects the savings of credit union members.
- 10.1.2 This Chapter sets out the recommendations of the Commission on Credit Unions with regard to the regulation of credit unions to underpin the future evolution of the sector having regard to its particular ethos and nature and to ensure a stable credit union sector^{xxvi}.
- 10.1.3 As with other financial institutions, credit unions depend on public confidence for their success. Members need to be assured that their savings are safe.
- 10.1.4 Since the enactment of the Credit Union Act 1997, the credit union sector has changed significantly. Credit unions have grown both in terms of the size of their assets and the associated risks.
- 10.1.5 A new regulatory framework specific to credit unions is required in order to reflect the development of the sector and to bring the risk profile of some credit unions into balance with their current capabilities as financial institutions and to realign the overall risk profile of the credit union sector to a more manageable and sustainable level that is consistent with the ethos of the sector. The new regulatory framework should be built around the principles of responsibility, accountability, prudence, compliance and transparency.
- 10.1.6 The Commission notes that in making regulations, the policies and principles should be set out in primary legislation with the relevant standards and procedures to be dealt with in Central Bank regulations.
- 10.1.7 This Chapter sets out the proposed new legislative provisions under a number of categories. The proposed new Credit Union Bill will carry the main legislative provisions in relation to the new regulatory regime for credit unions. It will also contain changes to the Credit Union Act 1997, some of which are required to underpin this regime, others that are miscellaneous changes that will ease operations at credit unions. New legislation relevant to the supervision of credit unions will also be carried in the Central Bank (Supervision and Enforcement) Bill 2011, currently at Committee Stage in Dáil Éireann.
- 10.1.8 An important change to the current Section 35 Regulatory Requirements in respect of

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the rescheduling of loans was also recommended by the Commission and is set out later in this Chapter at Section 10.6.

- 10.1.9 The Commission's Terms of Reference includes a requirement to also consider the question of the prudential supervision of loan societies and credit co-operatives registered under the Friendly Societies Act 1896 and the Industrial and Provident Societies Act 1893 that engage in taking deposits from and providing loans to their members. The Commission's recommendation on the next steps to be taken in this regard is set out at the end of this Chapter.

10.2 Consultation and assessment of regulatory impacts

- 10.2.1 Regulation should be conducted in a manner that is reasonable, appropriate and transparent. We are now moving to a new regulatory framework and when setting out a new regulation, the Commission recommends that the Central Bank undertake a Regulatory Impact Analysis (RIA²⁵) in line with existing requirements and having regard to international best practice, which should also include full and meaningful consultation with credit union representative bodies as well as individual credit unions. The Regulatory Impact Analysis should be cognisant of the new regulation's impact on the development of credit unions.
- 10.2.2 According to the White Paper of Better Regulation (2004), a RIA is a tool to be used by policy and law makers designed to identify and quantify, where possible, the impact of new regulations, so long as it does not place an undue burden on the assessment process. It can also be used in the review of existing regulations. In essence, RIA attempts to clarify the relevant factors for decision-making through the comprehensive and systematic compilation of information. It encourages regulation-makers to make balanced decisions when considering legislative action that trade off possible solutions to a problem, against the wider economic and distributional goals. A RIA, in the case of credit unions, would take into account any potential compliance issues including compliance costs, and the need to avoid unintended consequences. When undertaking a RIA, alternative approaches to tackling the issue should be considered, including the possibility of not issuing a regulation where the problem can be solved by other means.
- 10.2.3 To this end, the Commission recommends that a consultation protocol should be in place between the Central Bank and credit unions. This protocol should be developed following consultation between the Central Bank, the Minister, Credit Union Representative Bodies and the Credit Union Advisory Committee²⁶. It will set out how the Central Bank proposes to engage with credit unions in any formal consultation process prior to the introduction of new regulations. The protocol may provide for varying levels of consultation depending on the nature and complexity of the

²⁵ See further: Department of the Taoiseach (2004) *Regulating Better* (Dublin, Official Publications Office) and Revised RIA Guidelines – June 2009

²⁶ The Credit Union Advisory Committee is established under Section 180 of the Credit Union Act 1997, to advise the Minister and such other persons as the Minister thinks fit in relation to the improvement of the management of credit unions, the protection of the interests of members and creditors of credit unions, and other matters relating to credit unions upon which the Minister, the Central Bank or such other persons as may be specified by the Minister may from time to time seek the advice of the Committee.

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regulation being proposed. This will have the effect of increasing transparency and confidence in the regulation making process. This protocol should include the specific requirement that consultation does not impact on the statutory independence of the Central Bank in the regulation of credit unions.

- 10.2.4 Furthermore, the Commission recommends that regulations made pursuant to the legislation should be necessary, effective and proportionate having regard to the nature, scale complexity of credit unions or to the class or classes of credit union to whom the regulations will apply. This would also facilitate a tiered approach to regulation as recommended in Chapter 7.
- 10.2.5 The Commission notes that, under Section 32L of the Central Bank Act 1942 (as amended by the Central Bank Reform Act 2010), the Central Bank must publish an Annual Performance Statement and that the Central Bank must specifically report on the work done by the Registrar of Credit Unions and the Governor or Deputy Governors may be called before an Oireachtas Committee to discuss the report. Under Section 32M of the Central Bank Act 1942 (as amended by the Central Bank Reform Act 2010), there is a provision for an international peer review of the Central Bank's performance. This is important given the powers, responsibilities and objectives of the Central Bank to administer the system of regulation and supervision of credit unions with a view to the protection by each credit union of the funds of its members, and the maintenance of the financial stability and well-being of credit unions generally as well as the stability of the financial system overall.

10.3 Outline of proposed Credit Union legislation to implement the recommendations of the Commission

- 10.3.1 Publication of the Credit Union Bill by end-June 2012 is a structural benchmark under the EU-IMF Programme.
- 10.3.2 As noted above, the Commission has recommended that the proposed credit union legislation should set out the principles and policies with regulation making powers delegated to the Central Bank. Regulations made by the Central Bank would set out the detail of the relevant standards and procedures following full and meaningful consultation with the credit union sector. The purpose of the legislation will be to provide for a strengthened legislative framework, including more effective governance and regulatory requirements, which aims to reflect the development of a modern credit union sector and facilitates the tiered approach to regulation outlined elsewhere in this Report. The Commission recognises that credit unions that wish to take on additional scale and complexity through the provision of additional services should be required to mitigate the associated risks by complying with additional requirements to those placed on credit unions offering core services only.
- 10.3.3 The Minister for Finance asked the Commission on Credit Unions to provide a recommendation on the application of the Central Bank (Supervision and Enforcement) Bill 2011 (the Supervision and Enforcement Bill) to credit unions. The Commission recommended that the powers and functions intended under the Supervision and Enforcement Bill 2011 be applied to credit unions. However, the Commission did not arrive at a single position as to the statutory mechanism for applying these powers and functions to credit unions. The Minister for Finance has

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stated that he will keep this matter under review as work on the Credit Union Bill and the Supervision and Enforcement Bill 2011 progresses.

- 10.3.4 The Central Bank (Supervision and Enforcement) Bill 2011 provides extensive regulation making powers to the Central Bank which may be used for credit unions. The Credit Union Bill will provide additional regulation making powers to the Central Bank.
- 10.3.5 The Department of Finance presented a preliminary draft of the heads of the Credit Union Bill²⁷ at the Commission. The draft was presented for discussion purposes only and is subject to continued consideration by the Department of Finance and the Central Bank. The draft is further subject to approval by the Minister for Finance and the Government. The material was presented as a draft work-in-progress and does not purport to be a complete formal proposal from the Department of Finance or Central Bank and has not been approved by the Office of the Attorney General. The heads will be subject to further development with further additions and amendments before being submitted to Government for approval and during the drafting process prior to publication. The heads were circulated for the purposes of updating the Commission on Credit Unions and to provide an opportunity for feedback. The Commission recommends that it be reconvened to review the draft heads at a later stage prior to publication and requests that the Minister facilitate this.
- 10.3.6 The following provides an outline of the proposed provisions of credit union legislation as presented to the Commission. Some of these provisions may be covered in the Central Bank (Supervision and Enforcement) Bill 2011.

It is intended that the legislation would cover the following areas:

- a) Prudential Requirements
 - b) Governance
 - c) Stabilisation
 - d) Restructuring
 - e) Amendments to the Credit Union Act 1997
- 10.3.7 As governance, stabilisation and restructuring have been covered in the other chapters of this Report, the following will deal with the proposed provisions of (i) Prudential Requirements and (ii) Amendments to the Credit Union Act 1997.

Power to Make Regulations and the Prudential Rule Book

- 10.3.8 The Commission has recommended that the new credit union legislative framework, (including a new Credit Union Bill), should provide the Central Bank with the powers to make regulations that set prudential controls, limits, standards and requirements for credit unions.
- 10.3.9 To ensure that regulation is conducted in a reasonable and transparent manner, regulation should be based on written rules and prudential standards and it should, to

²⁷ Heads of Bill set out the general scheme of a proposed Bill. They provide a working document which seeks to set out in general terms the provisions to be covered by the Bill. Once the heads have been finalised the parliamentary draftsman will produce the formal text of the Bill which will be put to the Oireachtas.

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the extent practicable, prescribe outcomes rather than methods. The written rules and prudential standards should be sufficiently detailed so that credit union officers are clear as to what actions they are required to take and what actions they are prohibited from taking. However, the rules and prudential standards should only restrict credit unions to the extent necessary to maintain their prudential soundness and as otherwise required by law and should not be so detailed as to interfere unnecessarily with the responsibility of those officers to exercise their own judgement and discretion in managing their credit union for the benefit of their members.

- 10.3.10 To this end, the Commission recommends the introduction of a Prudential Rule Book that would set out in detail what is required in each of the relevant areas. The Rule Book should include prudential controls, limits, standards and requirements on key areas, including: reserves; lending; investments; borrowing; members' savings; liquidity; governance; risk management systems and controls; fitness and probity; operations; consumer protection; administration; supervision; and enforcement. The statutory basis of the Rule Book should give the necessary authority to the rules while the detailed contents would remain a matter for the Central Bank following full and meaningful consultation between the Central Bank and credit union movement stakeholders.
- 10.3.11 An overview of proposed legislation providing the Central Bank with these regulation making powers is set out below.

Prudential Requirements

- 10.3.12 Under each of the headings in this section, it is understood that (a) the Central Bank is responsible for setting the requirements that credit unions must meet, (b) that these requirements may be set for all credit unions or a class or classes of credit unions and (c) that each credit union is responsible for developing appropriate policies and contingency plans and putting in place robust systems and procedures. The following describes the draft heads of the proposed bill in broad outline.

Preliminary issues

- 10.3.13 The draft heads of bill provide for full and meaningful consultation with the credit union sector. The Central Bank should consider the necessity for the proposed regulation, and ensure that it is effective and proportionate in achieving the objective of the regulation. Regulations made by the Central Bank may provide for the tiered regulatory approach recommended by the Commission by ensuring that it has regard to the nature, scale and complexity of the credit unions or class or classes of credit unions at which the regulation is aimed.
- 10.3.14 While the Central Bank is responsible for the regulation of the credit union sector, the draft heads of bill place the onus on individual credit unions to ensure that they put in place the appropriate policies, procedures, systems, controls and reporting arrangements to meet and monitor compliance with the legislative and regulatory requirements set out in law and the Central Bank may make regulations in this regard. Where the credit union fails to meet these requirements, the credit union shall be required to take such action as necessary to ensure it returns to compliance as soon as possible.

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Reserve requirements

- 10.3.15 The draft heads of bill provide that the Central Bank may make regulations specifying the minimum level of reserves that a credit union should maintain, which is adequate having regard to the nature, scale and complexity of the business model of the credit union. This may involve replacing the statutory reserve. Certain credit unions may also be required to apply risk weights to their assets.
- 10.3.16 To protect against operational risk, the Commission recommends that each credit union should be required to hold reserves in addition to the minimum reserve requirements. The Central Bank may make regulations in relation to the minimum level of operational risk reserves credit unions will be required to hold. In addition, when considering the appropriate levels of reserves it should hold, each credit union will be required to assess the level of operational risk to which it is exposed.
- 10.3.17 Where a credit union falls below its reserve requirement, it will be required to take such action as to bring it back into line with its requirements. This may include transferring all or part of its surplus to its reserves or requesting Central Bank approval before paying a dividend or loan interest rebate.
- 10.3.18 The draft proposals recognise that it may not be realistic for newly established credit unions to hold reserves of the level of established credit unions. Therefore, it is recommended that the Central Bank should be able to make regulations regarding initial reserve requirements for newly established credit unions. This may provide for a transition period for new credit unions to achieve the required minimum reserve.

Liquidity requirements

- 10.3.19 It is important that credit unions keep a proportion of their total assets in liquid form in order for them to be able to meet liabilities as they arise, to fulfil members' withdrawal requests within expected timeframes and to meet requirements in the event of pressure arising from unexpected events^{xxvii}. The draft heads of bill provide that the proposed minimum liquidity requirements may be set by the Central Bank in regulations.
- 10.3.20 Credit unions should also be required to hold a liquidity buffer in addition to the minimum liquidity requirement which is proportionate to the nature, scale and complexity of the credit union's activities. The Central Bank may make regulations in this regard, in circumstances where it is deemed necessary.
- 10.3.21 The draft heads of bill contain provisions so that each credit union can be required to develop and implement policies and procedures in relation to liquidity and to carry out regular liquidity stress tests that include an assessment of a 'worst case' scenario and identify contingency measures available to offset the impact should such a scenario occur.

Investments

- 10.3.22 In order to safeguard the assets of the credit unions, the draft heads of bill provide the Central Bank with regulation making powers in respect of investments that a

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credit union will be permitted to make. The Central Bank may also make regulations setting out investment class, concentration, jurisdiction and maturity limits to ensure that investment risks are mitigated and the liquidity of the credit union is preserved.

- 10.3.23 Credit unions must ensure that investments do not pose an undue risk to credit union members' savings. The Central Bank may make regulations setting out the various risks that a credit union should consider and prescribe the systems and controls that a credit union should have in place before making investments.
- 10.3.24 The draft heads contain provisions that each credit union can be required to develop investment policies, procedures, systems and controls.

Lending

- 10.3.25 Section 35 of the Credit Union Act 1997 provides the Central Bank with certain regulation making powers in relation to lending. Under the draft heads of bill, the Central Bank will be able to make regulations in additional areas of lending including the maturity profile of credit union lending and limiting exposure in relation to commercial lending.
- 10.3.26 To protect members' savings and the financial stability of the credit union, the draft heads of bill contain provisions so that certain requirements can be set, including requiring the board of directors of each credit union to adopt and implement policies, procedures and systems to manage lending and credit risk and to review their loan book on a regular basis, to verify the adequacy of the provision for bad and doubtful debts and to ensure that any resulting adjustments to the provision are incorporated into the regular management accounts.

Savings

- 10.3.27 Credit unions may raise funds by issuing shares or by accepting deposits. At present, the 1997 Act provides the limits on deposits and shares that credit unions may hold. The draft heads provide the Central Bank with the power to set these limits in regulations, as well as maximum exposure limits and ratios of deposits to shares.

Borrowing

- 10.3.28 Under the draft heads, the Central Bank will have the power to make regulations in relation to limits on borrowing and in relation to the management of credit union funding to ensure that it is aligned with the credit union balance sheet strategy and liquidity policy.

Risk management

- 10.3.29 The draft heads of bill provide that the board of directors of each credit union should be required to take the lead in establishing a strong risk management culture^{xxviii}.
- 10.3.30 Credit unions will be required to develop a strategic plan to demonstrate how the credit union is to implement the strategic objectives of the credit union.
- 10.3.31 The draft heads of bill provide that each board of directors should be required to

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develop, maintain, and review on a regular basis, risk management systems appropriate to the size of the credit union and the complexity of its operations. The risk management system should include a risk management policy, a risk management process, a risk register and effective systems and controls. These should be reviewed on a regular basis by the boards of directors of credit unions. The draft legislation provides that the Central Bank may make regulations in this regard.

- 10.3.32 The draft heads of bill provide for the appointment of a risk officer and a compliance officer whose roles and responsibilities may be set out by regulations made by the Central Bank. It is envisaged that these two offices could be combined in smaller credit unions which do not engage in complex business activities.
- 10.3.33 The draft heads make provision requiring credit unions to develop an internal audit function to provide for the independent oversight of the governance of credit unions. The roles and responsibilities of the internal audit function may be set out by regulations made by the Central Bank.

Operations

- 10.3.34 The draft heads of bill provide that credit unions must identify the operational risks to which they are exposed, or are likely to be exposed, and provide for the management and mitigation of those risks through the adoption and implementation of policies, process, systems and controls.
- 10.3.35 The proposals make provision enabling the Central Bank to make regulations in respect of the types of operational risk areas that are to be covered in the credit union's risk management process including records management, ICT, management information systems, business continuity and outsourcing.

10.4 Proposed Amendments to the Credit Union Act 1997

- 10.4.1 During its deliberations, the Commission undertook a thorough review of the Credit Union Act 1997 (the 1997 Act). A number of legislative amendments were put forward as a result of this review. These are listed in the Annex to this Chapter. Some important amendments to the 1997 Act are set out below.

Section 2 Definition of 'Special Resolution'

- 10.4.2 At present, a special resolution requires two meetings in order to be passed. At the first meeting, the resolution must be passed by not less than three quarters of members who have voted at the meeting. Following on from this, a further confirmation meeting must be held whereby a simple majority of those present and voting at the meeting confirms the resolution. The Commission feels that this is a very cumbersome process that is used where one meeting should suffice. The Commission recommends that the passing of special resolutions should be confined to one meeting only, requiring a majority of three quarters of members present and voting.

Section 10 (6) – Registered name

- 10.4.3 Credit unions should not be restricted in the name of the credit union displayed on the

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outside wall of the credit union office. It is recommended that credit unions should be allowed to maintain their own name on the outside of the credit union office even if that credit union is a sub-office of another credit union (for example following a transfer of engagements or restructuring).

Section 32 (3) – Restrictions on the withdrawal of shares

- 10.4.4 Section 32 deals with restrictions on withdrawal of shares and deposits. The intention is to protect the credit union in the case of a ‘run’ by requiring, if it so wishes, up to 60 days notice of withdrawal of shares. Secondly, it protects against a withdrawal of pledged shares or deposits.
- 10.4.5 Section 32(3) requires that where a member seeks to withdraw a share in, or deposit with, the credit union at a time when he has an outstanding liability (including contingent liability) to the credit union, whether as borrower, guarantor or otherwise, that withdrawal shall not be permitted unless the value of his/her remaining savings are not less than the amount of the outstanding liability or unless the withdrawal is approved by the board. No such approval, however, could allow the remaining savings to be less than 25% of the outstanding liability. This provision restricts a member from withdrawing money which had been lodged into his/her credit union account after a loan has been taken out, without board approval. For example, if a member has pledged shares of €2,000 and a loan of €10,000, if he subsequently lodges funds, he cannot withdraw them without board permission if the resulting shares are less than €10,000.
- 10.4.6 The Commission recommends that this provision be amended so that shares which have been pledged at the time of taking out a loan are recognised as the attached shares to the loan amount. Any subsequent lodgements and withdrawals would hence be free from the obstacles caused by the operation of this sub-section. In addition to easing some practical difficulties, this should also ease the way toward using ATMs and debit cards.

Section 35 - Making of Loans

- 10.4.7 Section 35(4) requires that the total amount outstanding in respect of loans made to non-qualifying members shall not exceed 10% of the loan book or such larger percentage as may be approved by the Bank of the total amount outstanding in respect of all loans made by the credit union.
- 10.4.8 The Commission has received several requests to review this sub-section as the provision appears to restrict credit unions from lending to long-standing members who have moved outside the common bond but continue to have a strong connection and loyalty to the credit union. The Commission proposes an amendment to allow the board of directors to decide the percentage of the loan book that may be lent to non-qualifying members.
- 10.4.9 It is also proposed that the approval process for a loan to a non-qualifying member should be the same as for other types of loans.

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Section 48 – Power to provide additional services

- 10.4.10 Section 48(4) requires that where a credit union wishes to provide new “additional services”, this decision must be agreed by two-thirds of membership attending at an annual general meeting. The Commission believes that this decision could be taken by the board of the credit union and it recommends an appropriate amendment to allow for this. Credit unions could, of course, decide to continue to require the AGM approval.

Section 135 (7)– Winding up by instrument of dissolution

- 10.4.11 Current legislation provides for a three month window for a member or other person with an interest or claim on the credit union funds to apply to the High Court to set aside the dissolution of the credit union. The Commission recommends that this be reduced to one month in order to be consistent with the procedure in relation to transfers of engagements and amalgamations.

Section 182 – Power of the Minister to make regulations

- 10.4.12 The Commission recommends that this Section should be reviewed in light of the regulation making powers which the Commission recommends should be given to the Central Bank under new legislation. While some regulation making power may be retained by the Minister, it is clear that there cannot be duplication of responsibility.

Section 184 – Certain enactments not to apply to credit unions

- 10.4.13 This section dis-applies the Central Bank Acts 1942 to 1997, the Building Societies Act 1989 and the Consumer Credit Act 1995 in respect of credit unions. It is clear that certain sections of the Central Bank Acts do in fact apply to credit unions. Credit unions are now subject to the Consumer Credit Directive and their obligations in this regard have changed since November 2011. It is recommended that a full review of the implications of the possible dis-applying of Section 184 be carried out, for example to ensure the Commission recommendations (including those in relation to Administrative Sanctions and Appeals) can be implemented.

10.5 Further miscellaneous legislative amendments to strengthen the regulatory framework

Inspections and Investigations

- 10.5.1 In its Interim Report, the Commission recommended that the Central Bank should have the powers to conduct inspections and investigations in credit unions or appoint authorised persons to conduct such inspections and investigations.
- 10.5.2 The Commission noted that Part 3 of the Central Bank (Supervision and Enforcement) Bill 2011 (the Supervision and Enforcement Bill) sets out a comprehensive authorised officer regime for the Central Bank to apply to regulated financial service providers. The Bill, as published, proposes to amend the 1997 Act to apply Part 3 to credit unions. The Commission notes that Section 53 of the Supervision and Enforcement Bill

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provides that the Central Bank may use its information gathering powers to co-operate with overseas regulators.

Provision of Reports and Disclosures

- 10.5.3 The Commission recommends that the Central Bank should have the ability to require credit unions to provide information, including regulatory returns submitted on a periodic basis and to review and analyse financial and statistical reports from credit unions in whatever form it requires as well, as having these reports independently verified where it considers this necessary.
- 10.5.4 The Commission notes that Part 2 of the Supervision and Enforcement Bill is based on a similar UK provision which could be used to allow the Central Bank to require a credit union to prepare and pay for an independent expert report on a regulatory matter. These reports could be used for diagnostic, monitoring and compliance purposes, including stress tests, for example. There are safeguards to ensure that the provision is used in a balanced and proportionate way, with due regard to the cost burden involved.
- 10.5.5 The Commission notes that Part 4 of the Supervision and Enforcement Bill proposes to provide protection from civil liability and victimisation for whistleblowers. The provisions are flexible enough to provide for protections outside the strict employer/employee context. The Bill also proposes to provide for a mandatory disclosure regime for those performing pre-approval controlled functions (senior or influential positions within financial service providers); failure to disclose could be grounds for an investigation and action under the fitness and probity regime.

Administrative Sanctions

- 10.5.6 The credibility of a regulatory regime rests in part on its ability to enforce its rules. At present, credit unions are not subject to the administrative sanctions regime that applies to other regulated financial service providers.
- 10.5.7 The Commission recommends that the administrative sanctions regime should be extended to credit unions. In particular, the Central Bank should have available as a sanction the power to (a) revoke registration, (b) remove or suspend employees, officers and directors who commit prescribed contraventions, (c) impose fines and (d) suspend the board of directors. The Commission notes that sanctions will be subject to the independent Irish Financial Services Appeals Tribunal (IFSAT)²⁸ process as is the case with other regulated financial service providers.
- 10.5.8 The Commission notes that Part 7 of the Supervision and Enforcement Bill makes provision for new enforcement measures. These include warning notices to alert the public to firms operating without authorisation; restitution orders; and the payment

²⁸ **The Irish Financial Services Appeals Tribunal** was established by the Central Bank and Financial Services Authority of Ireland Act 2003. It is an independent tribunal which hears and determines appeals from aggrieved parties against certain decisions of the Central Bank of Ireland. The Appeals Tribunal aims to provide an accessible, efficient and effective method of appeal in an informal and expeditious manner.

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of investigation costs by those convicted of an offence. New credit union legislation will also need to make provision for the application of the administrative sanctions regime to credit unions. Administrative sanctions will be appealable to IFSAT.

Regulatory Directions

- 10.5.9 Section 87 of the 1997 Act (as amended) permits the Central Bank to issue regulatory directions where it is satisfied that a number of conditions have been met. The Commission recognises that the Central Bank requires this power as a necessary aspect of credit union regulation. The Minister for Finance sought the Commission's recommendation on an appropriate appeal mechanism for these regulatory directions. The Commission has examined the approach in the Supervision and Enforcement Bill and the appeals mechanism provided for under the Central Bank Act 1942 regarding IFSAT. The Commission recommends that directions issued by the Central Bank under section 87 should be appealable to IFSAT.

10.6 Proposed changes to current Central Bank Regulatory Requirements

- 10.6.1 Section 35 of the 1997 Act sets out the limits that credit unions must comply with in respect of the total amount of funds that may be advanced to members in respect of longer-term loans, i.e. for periods exceeding 5 years.
- 10.6.2 Section 35 is an asset and liability instrument which is in place to protect the financial stability of credit unions. The funding of credit unions is predominantly provided on a short-term basis in the form of on-demand savings and consequently the Section 35 limits are necessary for the protection of the financial stability of credit unions.
- 10.6.3 In 2009, the credit union representative bodies requested that the Minister for Finance increase the Section 35 limits as credit unions were experiencing an increase in requests from members to reschedule their loans to enable a reduction in members' loan repayments and payment of loans over a longer period of time.
- 10.6.4 In order to facilitate credit unions and enable them assist members in financial difficulties, Section 35 was amended by way of the Central Bank Reform Act 2010 which increased the lending limit over 5 years for credit unions from 20% to 30% of the loan book. This increase in the 5 year limit was accompanied by a balancing provision that gave power to the Central Bank to impose requirements in relation to lending practices, reporting on loans, the holding of reserves, the holding of liquid assets against loans in excess of 5 years and systems, controls and reporting arrangements.
- 10.6.5 In November 2010, the Central Bank introduced the 'Section 35 Regulatory Requirements for Credit Unions' which include requirements to ensure that credit unions make and maintain adequate provisions for loans that are in doubt and have been rescheduled over longer time periods and to maintain adequate liquidity to support additional longer term lending.
- 10.6.6 As part of its work the Commission discussed the Section 35 requirements and proposes that the Central Bank considers revising a number of the requirements as set out below.

10.6.7 **Section 35 Regulatory Requirements - Proposed Amendments**

Proposed amendments to Section 2 of the Requirements²⁹

2. Lending Practices for Rescheduled Loans

2.1 Loans must only be rescheduled following a thorough credit assessment where the ability of the member to repay in accordance with the revised terms has been clearly established.

2.2 An application to reschedule a loan must be supported by appropriate fact finding and a new loan application. The application must be accompanied by evidence of the member's consent to reschedule the loan and evidence of the change in the member's circumstances.

2.6 Where a member's circumstances have improved and where the member's ability to repay has been clearly established, the credit union may determine it prudent to grant additional credit to a member with a rescheduled loan that has performed in accordance with the new terms for an appropriate period in most cases not less than one year. The provision held against the existing rescheduled loan must remain.

Any additional credit granted to a member with a rescheduled loan that has performed in accordance with its terms for a period of less than one year must be approved by the board and the rationale for extending such additional credit must be clearly documented.

2.7 Where a member's rescheduled loan has not performed in accordance with its terms for a period of at least one year and the member does not meet the requirements set out in 2.6, in limited circumstances if the credit union considers it necessary, small amounts of credit (maximum of €1,000 per member) may be granted to such members to cover exceptional expenses only. Any additional credit granted in these circumstances must be approved by the board and the rationale for extending such credit clearly documented. The maximum exposure limit for gross loans outstanding of this type at any one time is the higher of €5,000 or 0.5% of the Total Regulatory Reserve.

Proposed amendments to Section 3 of the Requirements

3. Provisioning for Rescheduled Loans

3.2 When a loan is rescheduled a minimum provision, identifiable as a provision for rescheduled loans and capable of being inspected and audited, must be made against the loan. This minimum provision must be the higher of 20% of the net loan and any provision that existed at the time of reschedule.

In exceptional circumstances (e.g. maternity leave of a fixed period) and where the loan is not in arrears at the time of reschedule, a credit union may review this

²⁹ See Section 35 Regulatory Requirements for Credit Unions at <http://www.centralbank.ie/regulation/industry-sectors/credit-unions/Documents/Section%2035%20Regulatory%20Requirements%20for%20Credit%20Unions%20-%20November%202010.pdf>

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requirement. Where such circumstances arise and the credit union determines it is prudent not to hold the full provision of 20% of the net loan, the decision must be reported to the board and the rationale must be documented.

3.8 Notwithstanding Requirement 3.7, where a rescheduled loan that has been rescheduled more than once has performed in accordance with the new terms since the last reschedule for a period of not less than one year, it may be appropriate to review the level of provision held but this must not be less than the minimum requirement of 20 per cent.

3.9 A trial period of up to a maximum of four months may be agreed with the member and applied to a rescheduled loan at the time of the initial reschedule. The minimum provisioning requirement, in accordance with Requirement 3.2, must be held from the initial reschedule date. Any alteration of the repayment conditions at the end of the trial period is not considered a second reschedule.

10.7 Industrial & Provident Societies

- 10.7.1 The Commission was asked to consider the question of the prudential supervision of loan societies and credit co-operatives registered under the Friendly Societies Act 1896 and the Industrial and Provident Societies Act 1893 that engage in taking deposits from and providing loans to their members and to make recommendations in this regard.
- 10.7.2 The Department of Jobs, Enterprise and Innovation gave a presentation to the Commission in October 2011 outlining the history, legislation, current operations and the concerns. In May 2011, when the Commission was established, six of these co-operatives / savings and loan societies existed. The Commission understands that this number has now reduced to four. The Registrar of Friendly Societies has no independent power of investigation over these bodies. He/she may intervene and carry out an investigation, but only in the event that sufficient support for any such investigation comes from within the entity concerned. No relevant compliance body exists. The entities provide financial services and are not subject to prudential regulation.
- 10.7.3 The Commission is concerned that the impression exists that these entities are akin to credit unions, even though they are not. Any negative events surrounding them could reflect badly, and unfairly so, on the credit union sector which is fully regulated.
- 10.7.4 The Commission recommends that the Department of Jobs, Enterprise and Innovation undertakes a full due diligence exercise on each of the remaining four entities. For each entity, the exercise should ascertain the following:
- a. The degree to which financial services are provided;
 - b. Its fitness to comply with credit union legislation and regulatory requirements;
 - c. Its fitness to comply with the proposed new provisions in respect of governance, fitness and probity and new regulatory requirements;
 - d. Its suitability to operate in a modern restructured credit union sector, as investigated by the Commission on Credit Unions.

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- 10.7.5 This report, containing the full account of the financial position, governance structures and the financial services these entities provide, should be submitted to the Minister for Finance and the Minister for Jobs, Enterprise and Innovation for a joint consideration of next steps.

Credit Union Act 1997 Proposed Amendments

| Section of Legislation | Area | Amendment | Rationale |
|------------------------|---|--|--|
| Section 2(1) | Special Resolution | Confine passing of special resolutions to one meeting only. | Currently special resolutions require two meetings, one to pass the resolution and another to confirm the resolution. It should not be necessary to hold the second confirmation meeting. Special resolutions are required for the dissolution of a credit union or for an amalgamation. |
| Section 2 (1) | Member of the family definition | Expand the member of the family to include common law spouses/civil partnerships. | To reflect modern treatment of the family in law. |
| Section 10(6) | Brand | Allow credit unions to affix a sub office name on the outside of its sub offices in addition to the registered name of the credit union. | Transferor credit unions feel a loss of identity when transferred to the transferee. Retention of the branch name on the outside of the branch building would help mitigate that loss of local identity. This has been raised as a concern for transferors. |
| Section 14 | Rules | Amend so that the obligation is upon credit unions rather than the Central Bank to ensure that any rule amendments that are introduced are in line with the legislation. | Credit unions should ensure that any rule amendments are not contrary to any legislation that may be relevant to credit unions. |
| Section 17(4) | Non- qualifying member | Amend to allow for a provision that once a person becomes a member he/she will remain a member even if he/she loses the common bond, subject to the rules of the credit union. | A credit union should be allowed to decide whether a person who loses a common bond should be allowed to continue to be a regular member. |
| Section 31(3) | Interest on Deposits | Change 'payable' to 'offered' | This removes an operational difficulty. |
| Section 32(3) | Restrictions on withdrawal of shares and deposits | Change so that the provision applies only to shares attached at the time the loan was issued. Provide that attached shares are not withdrawable. | This will ensure that savings made following the issuing of the loan are not attached and are available to the member to withdraw. |

Proposed amendments to the 1997 Act continued overleaf...

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Proposed amendments to the 1997 Act continued...

| Section of Legislation | Area | Amendment | Rationale |
|------------------------|---------------------------|--|---|
| Section 35(4) | Making of loans | <p>Section 35 (4) requires that the total amount outstanding in respect of loans made to non-qualifying members shall not exceed 10% of the loan book or such larger percentage as may be approved by the Central Bank of the total amount outstanding in respect of all loans made by the credit union.</p> <p>It is also proposed that the approval process for a loan to a non-qualifying member should be the same as for other types of loans.</p> | The Commission has received several requests to review this sub-section as the provision appears to restrict credit unions from lending to long-standing members who have moved outside the common bond but continue to have a strong connection and loyalty to the credit union. It is proposed to amend the provision to allow the board of directors to decide the percentage of the loan book that may be lent to non-qualifying members. |
| Section 37C(2) | Legal Conflict | <p>Resolve conflict between Regulation 17 of the European Communities (Consumer Credit Agreements) Regulations 2010 and the 1997 Act. For example, Regulation 17 of the European Communities Regulations 2010 provides for a right of withdrawal within 14 days from the date on which the period of withdrawal begins as set out in Regulation 17. Section 37(C)(2) of the 1997 Act, however, provides for a cooling off period of 10 days from the date of receipt of the credit agreement (with the ability to waive this right).</p> <p>It should be noted that the Consumer Credit Act only applies for loans between €200 and €75,000. The 1997 Act applies for loans over €200.</p> | In general terms the provisions in the 1997 Act should be looked at in the light of the Consumer Credit Regulations and Consumer Credit Act 1995. The difference in scope of the requirements in relation to size of loans should also be considered. |
| Section 46 | Savings Protection Scheme | Delete | To be overtaken by statutory stabilisation scheme. |
| Sections 48-51 | Additional services | These Sections may need to be amended to reflect the tiered approach to regulation but will remain largely similar for middle tiered credit unions. | To be reviewed to ensure consistency with tiered regulatory approach. |
| Section 48(4)(a) | Additional services | Amend so that a credit union does not require approval of an AGM before providing an additional service. | The decision of the board of directors should suffice in order for the credit union to begin providing an additional service. |

Proposed amendments to the 1997 Act continued overleaf...

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Proposed amendments to the 1997 Act continued...

| Section of Legislation | Area | Amendment | Rationale |
|------------------------|--------------------------------|--|--|
| Section 68(1)(c) | Remuneration | Remove Section 68(1)(c), which hasn't been commenced, so that there is no confusion over whether credit officers and credit control officers that are not directors can receive remuneration. | The section as it presently reads prohibits remuneration to all credit and credit control officers. |
| Section 69 | Conflicts of interest | Definition of connected person required | Definition could be taken from Central Bank (Supervision and Enforcement) Bill 2012. |
| Section 72 | Disqualifications | Amend to refer to offences in the previous 10 years. | |
| Section 73 | Giving of security by officers | Remove. | Taken from Industrial and Provident Societies Act 1893. |
| Section 87 | Directions | Insert provision to allow for appeal to IFSAT | The Commission recommends that Directions made under this section are appealable to IFSAT. |
| Section 109 (2)(b) | Availability of Information | Insert a provision in relation to timeliness of information. Insert 'is available as and when required by the Bank' as opposed to 'as required by the Bank'. | Including this amendment makes it clear that the credit union must produce information required by the Bank on a timely basis and ensures it is consistent with Section 109(2)(a). |
| Section 110 | Auditor | Include subsection (f) of the Companies (Amendment) Act 1986 to ensure consistency between the Companies Act and the 1997 Act in relation to this section. "(f) in determining how amounts are presented within items in the (profit and loss account) income and expenditure account and balance sheet, the directors of a (company) credit union shall have regard to the substance of the reported transaction or arrangement, in accordance with generally accepted accounting principles or practice." | The Companies (Amendment) Act 1986 has been amended to include subsection (f). This amendment should be reflected in the 1997 Act for consistency. Further consultation with the Department of Jobs, Enterprise and Innovation will be required. |
| Sections 110(1)(d) | Anomaly | Section (d) should read "of receipt or payment". | The Companies (Amendment) Act 1986 (from which section 110 of the 1997 Act is derived) states "of receipt or payment" However the 1997 Act states "of receipt <u>of</u> payment". It would appear that this is an error in the 1997 Act. |

Proposed amendments to the 1997 Act continued overleaf...

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Proposed amendments to the 1997 Act continued ...

| Section of Legislation | Area | Amendment | Rationale |
|------------------------|--------------------|---|--|
| Section 116 | Anomaly | Section 116 contains a reference to Schedule Five which was repealed by the CBFSAI Act 2004. | Removal of auditor provision to be reviewed in light of modern regulatory regime for auditors and processes for removal. |
| Section 125 | Dispute resolution | Section 125 and 126 will need to be reviewed to allow for recourse to the Financial Ombudsman, not the Central Bank, following exhaustion of internal complaints procedure. | The Central Bank and Financial Services Authority of Ireland Act 2004 only amended part of section 125. The entire section needs to be reviewed. |
| Section 130(1) | Anomaly | Amend last line to read "together with a copy of the annual accounts for each credit union concerned for the most recent financial year." | Section 130(3) requires credit unions to send their members "the financial position of each credit union concerned as appearing from the most recent unaudited monthly statements." This amendment would make section 130(1) consistent with section 130(3). |
| Section 130(2) | Anomaly | Insert new subsection (b) to read "A copy of the annual accounts for each credit union concerned for the most recent financial year" and rename the existing subsection (b) to become subsection (c). | Currently if a credit union wishes to proceed with a transfer of engagements by special resolution it must send a copy of its annual accounts to its members. If the credit union proceeds by way of board resolution it does not need to do so. This appears to be a drafting error which this amendment would correct. |
| Section 135(7) | Dissolution | Confine the period in which a member or other person can commence proceedings in the High Court to set aside the dissolution of a credit union to one month. | Currently a member or other person can commence proceedings in the High Court to set aside a dissolution within 3 months of a notice appearing in Iris Oifigiúil. This 3 month period is too long and delays the completion of a dissolution unnecessarily. |
| Section 136(2)(a) | Anomaly | Insert after the phrase "secretary or other officer" - "of the dissolving or transferor credit union." | In the case of a transfer of engagements, it is not clear from the legislation whether the secretary referred to is the secretary of the transferor or transferee credit union though it is implied it is the transferor secretary as the subsection refers to property vested in the credit union being conveyed or transferred. This appears to be a drafting error which this amendment corrects. |
| Section 171(4) | Offences | This Section should be amended to allow the Gardaí/DPP (in addition to the Bank) to pursue summary convictions under the Act. | This would allow the Gardaí /DPP to pursue convictions in addition to the Central Bank. |
| Section 182 | Powers | Section 182 should be reviewed in light of the proposed regulation making powers to be given to the Central Bank. | It will be necessary to ensure that there is no conflict or overlap of regulation making powers between the Minister for Finance and the Central Bank. |

Proposed amendments to the 1997 Act continued overleaf...

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Proposed amendments to the 1997 Act continued...

| Section of Legislation | Area | Amendment | Rationale |
|------------------------|--------------------------|--|---|
| Section 184 | Administrative Sanctions | Section 184 should be reviewed. It is suggested that a review of the implications of removing the dis-application of the Consumer Credit Act 1995 is considered in conjunction with the issue raised in relation to Section 37C(2) regarding the conflict between the Consumer Credit Regulations and the 1997 Act. | To ensure that credit unions are subject to the Central Bank Acts and the administrative sanctions, Financial Services Ombudsman and other relevant provisions can be applied. |
| Second Schedule | Anomaly | Remove 19 from the date. | To show the update in the new millennium. |
| Various | Fitness and Probity | Consequential amendments to 1997 Act to ensure that the fitness and probity regime under Part 3 of the Central Bank Reform Act 2010 operates effectively for credit unions. | For example, need to ensure nomination committee is on a statutory basis, nominations cannot be made from the floor, nominations must be received in time to allow the credit union ensure fitness and probity requirements are met. |
| Various | Electronic communication | The Commission recommends that a review of the 1997 Act be undertaken to assess whether it would be appropriate to allow electronic communication of notices, etc. | This would allow credit union reduce costs. |
| | Various | Requirement to report breaches by credit unions to the Gardaí. This should be amended that only serious criminal issues need to be reported e.g. fraud, manipulation of accounts, money laundering etc. Other breaches by credit unions should be sanctionable by Central Bank, e.g. failure to submit a return, breach of lending limits (Section 35 breaches). An example of a matter which should not have to be reported to the Gardaí is Section 63(5)(6) breaches - failure to notify Central Bank within 14 days of changes in directors. | Given that Administrative Sanctions Procedure will apply to credit unions, remove criminal offence provisions unless strictly necessary. |
| | Registration | Ability to require a credit union to meet certain conditions to be registered and to impose conditions on the registration. | This would ensure credit unions are consistent with other regulated financial service providers and credit unions in other jurisdictions. It would also allow for implementation of requirements such as business plan, appropriate personnel prior to authorisation. |

Proposed amendments to the 1997 Act continued overleaf...

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Proposed amendments to the 1997 Act continued ...

| Section of Legislation | Area | Amendment | Rationale |
|------------------------|---------|---|--|
| | Various | A number of the functions of the 1997 Act are vested in the Registrar of Credit Unions and he is not in a position where he can delegate the exercise of these functions. | It would facilitate effective regulation if the Registrar could delegate certain functions to Central Bank staff. |
| | Various | Review the 'reporting' requirements for credit unions within the 1997 Act that may need to be amended. E.g. Remove reporting requirement in Section 47 Insurance Against Fraud. | Credit unions are expected to comply with all legal and regulatory requirements and reporting should only be required as determined by the Central Bank |
| | Auditor | Require auditor's management letter to be received by the Central Bank within 1 month of the signing of the audited accounts. A reply from the Board should be received by the Central Bank 2 months after the auditor management letter. | Absence of timeline is an omission in the current legislation |
| | Auditor | Credit unions should be required to rotate their audit firm after a maximum engagement period of 6 years. A cooling off period of 4 years will be applicable before the same audit firm can be re-engaged by the credit union. | Assist in ensuring appropriate standards of auditing |
| | Various | Governance Code - Changes required to implement the governance recommendations in the final report of the Commission on Credit Unions. e.g. Treasurer, Supervisory Committee, remove need for a director to be a member of the credit committee, credit control committee and membership committee. | These changes will have to occur to be in-line with the Regulatory Rule Book. Without amending the 1997 Act, confusion will arise as to whether certain roles have or have not been removed. |

Chapter 11 – Governance of Credit Unions

11.1 Introduction

- 11.1.1 At its most fundamental, governance is about aligning the actions and choices of credit union boards and managers with the interests of members.
- 11.1.2 A good governance structure allows the organisation to achieve its desired results and to do so in the right way, that is, in a way that is consistent with the values of the organisation; something that is of particular importance to co-operative organisations such as credit unions.
- 11.1.3 There are two basic issues that need to be addressed, a need to decide where the organisation is going (setting the organisations goals, objectives and mission) and to decide how the organisation will get to where it wants to go (setting out the strategic plans, policies and structures) (Lowndes and Skelcher, 1998; World Council of Credit Unions, 2005).
- 11.1.4 The Interim Report of the Commission set out the initial recommendations of the Commission with regard to the governance of credit unions to underpin the future evolution of the sector having regard to its particular ethos and nature and to ensure a stable credit union sector.^{.xxix}
- 11.1.5 The issue of governance of credit unions is at the core of strengthening the regulatory framework and setting out a strategy for the future evolution of the credit union sector. Reforming and strengthening the governance of credit unions will not only be crucial to addressing the issues that currently exist in the sector but also for providing for a healthy and stable sector into the future.^{xxx.}
- 11.1.6 The safe and sound operation of each credit union is the responsibility of its democratically elected officials and management. All credit unions should be required to have robust governance arrangements. In particular, there should be a clear organisational structure with well defined, transparent and consistent lines of responsibility. Moreover, the roles, responsibilities and accountabilities of the board of directors, approved officers, management and committees should be clearly set out by each credit union.^{xxxi}
- 11.1.7 While a clear organisational structure is important, such a structure will only serve its purpose when all elements of the governance structure are active in carrying out their roles in a competent manner to ensure the prudent and ethical operation of credit unions.
- 11.1.8 As credit unions operate in a regulated environment, they should be subject to rules, policies, prudential standards and supervisory activities in order to ensure effective democratic governance of all credit unions in accordance with best international practice. Adherence to standards of governance, fitness and probity and competency must be adequately monitored and the Central Bank must have the powers to sanction failure by a credit union to achieve appropriate standards.

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11.1.9 The key recommendations with regard to the governance of credit unions set out in the Interim Report were as follows:

- a recommendation that credit unions should be required to establish and document robust governance arrangements for risk management;
- a recommendation that it be mandatory that credit unions appoint a risk management and compliance officer and that the credit union's annual report should include a risk management and regulatory compliance statement;
- a recommendation that the Credit Union Act 1997 be amended to insert a provision requiring each credit union to develop an internal audit function to provide for the independent internal oversight of the governance of credit unions, and
- a recommendation that responsibility for examining the books and documents of the credit union, including an inspection of securities, cash accounts and all records relating to loans^{xxxii}, and for a comparison between the pass-book or statement of account of a sample of all members of the credit union should cease to be a function of the Supervisory Committee^{xxxiii} and instead come under the internal audit function.

11.2 Governance Standard - Overview

11.2.1 The Governance Standard emphasises the importance of, and provides a framework to implement in practice, a separation between the two distinct sets of roles in a credit union, i.e. the executive or operational roles, and the non-executive or governance roles. This separation allows the respective roles to be clearly defined and for their responsibilities to be distinct. The executive or operational roles are performed by the manager, the management team, staff and voluntary assistants. The non-executive or governance roles are performed by the board. Separating these two sets of roles ensures that there is clarity as to which individuals are responsible for the management of the credit union and its on-going operations and which individuals are responsible for the governance and supervision of the management team. Allowing any overlap between these roles would create a risk of conflicts of interest, and would increase the potential for failures in governance. The clear distinction of roles is fundamental to the governance requirements and is essential to ensure that a workable governance structure can be created in all credit unions, regardless of nature, scale or complexity, and to ensure the safeguarding of members' funds.

11.2.2 The governance requirements set out the role and responsibilities of two key positions within the credit union - those of chair of the board and manager of the credit union. Under existing legislation, the treasurer is identified as the 'managing director' of the credit union and his/her responsibilities include executive responsibilities such as submitting financial statements to the board. In order to ensure that the role and responsibilities of board and management do not overlap and that board members have governance rather than executive responsibilities, the Commission recommends that the 1997 Act is amended to remove the role of treasurer and assign executive responsibilities to the management of the credit union. However, cognisant of the fact that credit unions are financial institutions the Commission recommends that the board should include at least one director with specialised expertise, qualifications and background in financial services and/or

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accounting matters (see 11.3.28).

- 11.2.3 A robust internal audit function is essential to the successful governance of any financial institution. The Interim Report recommended that each credit union should be required to develop an internal audit function to provide for the independent internal oversight of the governance of credit unions. It is the Commission's intention that credit unions will develop an internal audit function, including an internal audit committee, that will contribute to safeguarding the assets of the credit union by evaluating and reporting on the effectiveness of risk management, internal control and governance processes to address weaknesses which can cause financial instability. It is the Commission's intention that the internal audit function will report directly to the board of directors on a quarterly basis or as otherwise (see 11.3.63).
- 11.2.4 The governance requirements set out the board committees that a credit union must maintain at a minimum. Existing legislation requires credit unions to establish a number of committees with executive responsibilities (Credit, Credit Control, and Membership). These committees are currently required to include at least one member of the board. In order to ensure the principle of separation of governance and executive responsibilities is preserved, the Commission recommends that the existing legislation is amended so that these Committees no longer require the inclusion of a member of the board (see 11.3.73).
- 11.2.5 The Interim Report recognised the important role the Supervisory Committee has in overseeing and reporting to members on the performance of the board. The Interim Report also recognised the importance of ensuring that the role of the Supervisory Committee does not overlap with the new internal audit function and recommends that operational responsibilities currently assigned to the Supervisory Committee should be transferred to the internal audit function. In recognition of the change to the Supervisory Committee's responsibilities and the key oversight role played by the Supervisory Committee, the Commission recommends that the Supervisory Committee is renamed as the Board Oversight Committee and the primary function of the Board Oversight Committee should be to assess whether the board has operated as required by the governance requirements (see 11.3.85).
- 11.2.6 The governance requirements shall apply to credit unions in addition to any Fitness and Probity requirements that apply to credit unions and individuals in credit unions.
- 11.2.7 Legislative amendments will be required to give effect to the governance requirements and to ensure that the 1997 Act is consistent with and supports the requirements. Analysis of the legislative amendments required will form part of the work being undertaken to draft the credit union legislation due to be presented to the Oireachtas by end June 2012.
- 11.2.8 The Interim Report also identified a number of governance areas to be considered by the Commission during the second phase of its work. The Governance Standard as set out in Section 11.3 is recommended by the Commission. Further requirements on risk management and internal audit will be contained in the Prudential Rule Book.

11.3 Governance Standard

- 11.3.1 The Governance Standard sets out the proposed requirements to apply to credit unions. As such, it uses the formal language needed for binding requirements, and is

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unlike the other parts of the Final Report in that respect. Where the word ‘shall’ is used, this indicates a compulsory requirement. On the other hand, the word ‘may’ indicates discretion in the way a power or function is to be exercised.

General Requirements

- 11.3.2 This section sets out the minimum Governance Standard that a credit union shall meet in the interests of promoting strong and effective governance. Consideration will be given to the level of application of the Governance Standard to credit unions in the Type 1 category of the tiered regulatory approach (see Chapter 7).
- 11.3.3 The board retains primary responsibility for corporate governance within the credit union at all times. Nevertheless, senior management plays an important part in ensuring effective governance and is therefore responsible for operating effective oversight consistent with board policy.
- 11.3.4 Each credit union shall have robust governance arrangements which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks to which it is or might be exposed, adequate internal control mechanisms, including sound administrative and accounting procedures, ICT systems and controls, remuneration policies and practices that are consistent with and promote sound and effective risk management. The governance arrangements shall be subject to regular internal review.
- 11.3.5 The governance structure put in place by each credit union shall be sufficiently sophisticated to ensure that there is effective oversight of the activities of the credit union, taking into consideration the nature, scale and complexity of the business being conducted.
- 11.3.6 No one individual may have unfettered powers of decision.
- 11.3.7 The corporate governance arrangements and policies shall be articulated clearly and communicated to all appropriate staff within the credit union.

Reporting to the Central Bank

- 11.3.8 Any credit union which becomes aware of a material deviation from the governance requirements shall, within five business days, report the deviation to the Central Bank, advising of the background to the deviation and the proposed remedial action.
- 11.3.9 Each credit union shall submit an annual compliance statement to the Central Bank, in accordance with any relevant guidelines issued by the Central Bank, specifying whether the credit union has complied with the governance requirements during the period to which the statement relates.
- 11.3.10 This compliance statement shall be submitted to the Central Bank within two months of the end of each financial year, or with such other frequency as the Central Bank may notify to the credit union from time to time.
- 11.3.11 In the event of the credit union deviating materially from the governance

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requirements, the compliance statement shall include a report on any material deviations, advising of the background to the breach and the actual or proposed remedial action.

Composition of the board

- 11.3.12 The board of a credit union shall be of sufficient size and expertise to oversee adequately the operations of the credit union. The board of a credit union shall comprise an odd number of directors, with a minimum of seven³⁰ and a maximum of 11.³¹
- 11.3.13 The directors of the credit union shall be appointed by the members of the credit union, according to the procedures prescribed in the 1997 Act and any other applicable requirements.
- 11.3.14 Where after an inspection or investigation the Central Bank considers that it is necessary to enhance or augment the expertise on the board, the Central Bank may require a credit union to nominate one additional member, with the required skills and expertise, to be appointed to the board of the credit union subject to the approval of the Central Bank. A director appointed in this manner shall have the same rights, duties and obligations as any other director.
- 11.3.15 A credit union shall ensure a majority of its directors are reasonably available to the Central Bank at short notice, if so required.
- 11.3.16 Each member of the board shall have sufficient time to devote to the role of director and associated responsibilities. The nomination committee shall indicate to prospective candidates the time commitment expected from directors by notice in writing.
- 11.3.17 A credit union board shall not permit any of the following to become or remain a member of its board:
- i. an employee of that credit union or any other credit union, regardless of whether that employment is on a full or part-time basis
 - ii. a voluntary assistant of that credit union or any other credit union
 - iii. a member of the board oversight committee of that credit union or any other credit union
 - iv. a director of any other credit union
 - v. an employee of a representative body of which the credit union is a member, where that employee's role could expose them to a potential conflict of interest
 - vi. an employee or board member of any public body or state agency involved in the regulation of credit unions
 - vii. an auditor of the credit union
 - viii. a solicitor or other professional advisor who has been engaged by, or on behalf of, the credit union within the last three years
 - ix. a member of the credit union who is in arrears for more than 90 days under a debt obligation to the credit union

³⁰ WOCCU recommends a minimum of five board members.

³¹ WOCCU recommends a maximum of nine board members.

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- x. a person who is a spouse, civil partner or co-habitant³², parent or child of a board member, board oversight committee member, employee or voluntary assistant of that credit union.

Role of the board

- 11.3.18 The board of a credit union shall perform its duties in an entirely non-executive manner, and shall not be involved in the performance of executive functions.
- 11.3.19 The performance of executive functions in the credit union shall be delegated by the board to the manager, and the board shall supervise the performance of executive functions.
- 11.3.20 The board shall be responsible for the appointment of a manager and the approval of the appointment of any other senior staff who may have a material impact on the risk profile of the credit union. The board shall be responsible for ensuring that such staff have the appropriate integrity and adequate knowledge, experience, skill and competence for their roles, and that they are appointed in accordance with all applicable requirements.
- 11.3.21 The board shall be responsible for reviewing the performance of the manager annually and monitoring the performance on an on-going basis to ensure continued appropriateness for the role and alignment with the strategy and objectives of the credit union.
- 11.3.22 The board shall be responsible for ensuring that the performance of all other senior staff is reviewed annually and monitored on an on-going basis, ensuring their continued appropriateness for the role, and ensuring that there is an appropriate succession plan in place for senior management.
- 11.3.23 The board shall be accountable to the members of the credit union and to the Central Bank, and shall be able to explain its decisions to the members and the Central Bank.
- 11.3.24 Each member of the board shall have the necessary knowledge, skills, experience, expertise, personal qualities, competencies, capabilities, professionalism and probity to carry out their duties and obligations and to effectively govern the credit union.
- 11.3.25 Having regard to paragraph 11.3.24, and in addition to any other applicable requirements, each member of the board, and the board collectively, shall have relevant financial services expertise, qualifications and background, or be required to undertake relevant and timely comprehensive training, to a sufficient extent that they can comprehend at a minimum each of the following:
 - i. the nature of the credit union's business, operating principles, activities and related risks
 - ii. their individual direct and indirect responsibilities and the board's collective responsibilities
 - iii. the credit union's financial statements.
- 11.3.26 The board shall ensure that each director undertakes and completes appropriate

³² Within the meaning of the Civil Partnership and Certain Rights and Obligations of Co-habitants Act 2010.

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training to support the requirements above. The board shall not allow a director to remain as a member of the board where the director fails to complete such training within a reasonable time of that training being made available to them.

- 11.3.27 The board of the credit union shall be responsible for the general control, direction and oversight of the credit union. The board's responsibilities shall include, at a minimum:
- (i) setting the strategy for the credit union by, inter alia, participating actively in constructively challenging and developing strategies proposed by the manager, executive team or others
 - (ii) debating all matters of material relevance to the credit union, operating a robust decision-making process and documenting the reasons for its decisions
 - (iii) maintaining effective, prudent and ethical oversight of the entity as a whole and ensuring there are appropriate systems and controls in place to achieve this
 - (iv) ensuring that there is an effective executive team in place and exercising appropriate oversight over execution by the executive team of the agreed strategies, goals and objectives, and monitoring and reporting on its performance
 - (v) ensuring that risk and compliance are properly managed in the credit union and that all regulatory requirements are met
 - (vi) removing from office an officer or committee member, except members of the board oversight committee, for failure to perform his or her duties or responsibilities
 - (vii) approval of all significant policies in the credit union, including but not limited to:
 - a. lending policies and limits
 - b. policies in relation to members' shares and deposits including the setting of a maximum number of shares and a maximum amount that a member may deposit
 - c. investment policy
 - d. designating of depositories for the funds of the credit union, and signatories to cheques, drafts or similar documents drawn on an account of the credit union
 - e. standards of conduct and ethical behaviour for directors and employees.
- 11.3.28 The board should include at least one director in its elected membership with specialised expertise, qualifications and background in financial services and/or accounting matters to support the board in carrying out its responsibilities.
- 11.3.29 The board shall define and document the roles, responsibilities and reporting lines of each of the following, to ensure that responsibilities are clearly understood by each and to ensure that no single person has unfettered control of the business:
- i. the board
 - ii. board members individually
 - iii. the chair and any other distinct role on the board, including vice-chair and secretary
 - iv. board committees
 - v. the manager and other members of senior management.
- 11.3.30 The board shall formally review its overall performance, relative to its objectives, at least annually and implement any necessary changes and improvements. The review

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shall be documented.

- 11.3.31 The board of each credit union shall document a formal schedule of matters reserved for the board. This schedule shall document all categories of matters which shall be decided upon by the board and which cannot be delegated to executive staff.
- 11.3.32 The board shall at all times ensure that it acts in a manner free from conflicts of interest.
- 11.3.33 The board shall document a policy for identifying, managing and resolving conflicts of interest, which applies to all credit union personnel, including board members and staff.
- 11.3.34 Each board member shall identify all potential conflicts between their own interests, of whatever kind, and the interests of the credit union. They shall take steps to ensure that their role on the board is not influenced by any other interest. Directors shall not participate in any decision making or discussion where a reasonably perceived potential conflict of interest exists.
- 11.3.35 If recurring or on-going conflicts of interest arise, the board members concerned shall seek guidance from the chair and where appropriate resign from membership of the board.

Chair

- 11.3.36 The board of every credit union shall elect one of its members to act as chair of the board, subject to that person being eligible to act as chair of a credit union.
- 11.3.37 The appointment to the role of chair shall be for a period of one year. The chair of a credit union shall not serve more than three consecutive terms in that role.
- 11.3.38 The role of the chair shall include the following responsibilities, at a minimum:
 - i. leading the board
 - ii. encouraging critical discussions and debate
 - iii. promoting effective communication between the board and management of the credit union
 - iv. setting the agenda, attending and chairing board meetings
 - v. ensuring acceptable board composition, renewal and succession planning
 - vi. conducting performance evaluation of board members
 - vii. facilitating the work of the board oversight committee
 - viii. ensuring that conflicts of interest are appropriately managed by the board and all board members.
- 11.3.39 An individual that has been an employee of a credit union, or acted in any executive role in a credit union during the previous five years shall not be appointed to the role of chair of that credit union.

Manager

- 11.3.40 Each board shall appoint an individual to the role of manager of the credit union.

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- 11.3.41 The manager is the most senior executive responsible for the credit union, and has ultimate executive responsibility for the credit union's operations, compliance and performance. The manager serves as the main link between the board and the executive functions in the credit union.
- 11.3.42 The manager shall have the necessary knowledge, skills, experience, expertise, personal qualities, competencies, professionalism, fitness and probity to carry out his or her duties and obligations.
- 11.3.43 Having regard to paragraph 11.3.41, and in addition to any other applicable requirements, the manager shall have relevant financial services expertise, qualifications and background, or be required to undertake relevant and timely comprehensive training, to a sufficient extent that they can comprehend each of the following:
- i. the nature of the credit union's business, operating principles, activities and related risks
 - ii. his or her individual direct and indirect responsibilities
 - iii. the credit union's financial statements
- 11.3.44 The role of the manager, and the division of responsibilities between the manager (and other executives) and the board shall be clearly established, formally documented in writing and agreed by the board.
- 11.3.45 The role of the manager shall include, at a minimum:
- i. proposing strategies to the board for debate, scrutiny and approval
 - ii. executing the strategies agreed by the board to the highest possible standards
 - iii. updating the board on the financial position of the credit union including submitting unaudited financial statements that set out the financial position of the credit union to the board on a monthly basis
 - iv. ensuring that the business and activities of the credit union are conducted and managed in a prudent manner
 - v. ensuring that proper systems of internal control are kept by the credit union.

Nomination and appointments

- 11.3.46 All credit unions shall establish a nomination committee, all members of which shall be directors. Additional requirements for board committees, including the nomination committee (11.3.73).
- 11.3.47 The nomination committee should be responsible for ensuring the credit union meets any requirements in relation to the fitness and probity regime (see 11.6).
- 11.3.48 The nomination committee, having considered the composition of the board, shall be responsible for identifying candidates to be nominated for appointment, proposing them to members and ensuring that there is an appropriate succession plan in place for the board.
- 11.3.49 In considering or proposing director appointments, the nomination committee shall assess and document its consideration of potential conflicts of interest among its members, including, but not limited to personal relationships, business relationships, the nomination committee member's own board involvement and common

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directorships among its members or proposed members and shall bring any potential conflicts of interest identified to the attention of members at the General Meetings.

- 11.3.50 Appointments shall not be proposed or proceed where possible conflicts of interest may emerge which are significant to the overall work of the board.
- 11.3.51 The nomination committee shall ensure that all directors are given adequate induction to their role on the board, to ensure that they have sufficient appreciation of, and appropriate training about, the strategy, operations and performance of the credit union. The nomination committee shall ensure that the induction process and training occur in a timely manner, but no later than 6 months following a director's appointment to the board. The nomination committee shall routinely update the training, as necessary, to ensure that the board makes informed decisions.
- 11.3.52 The nomination committee shall review board membership at least once every year. The nomination committee shall formally review the board membership of any person who is a member for more than nine years in aggregate, and it shall document its rationale for any continuance. The frequency with which board membership is renewed shall be documented. The renewal frequency shall consider the balance of experience and skills required by the board.
- 11.3.53 Board members shall not serve on the board for more than 9 years in aggregate in any 15 year period. For existing board members, the 9 year period commences from the date on which this regulation comes into effect.
- 11.3.54 The combined number of years a person has served on either the board or the board oversight committee may not exceed 9 years in aggregate in any 15 year period. The transitional arrangement in 11.3.53 also applies here.
- 11.3.55 Board members shall not serve more than three consecutive years in any one principal post.

Strategy

- 11.3.56 The board shall prepare a strategic plan which documents the strategy and objectives of the credit union.
- 11.3.57 The board shall monitor the credit union's implementation of the strategic plan, assess the performance of the credit union against the measurements defined in the strategic plan, and assess how the strategic objectives of the credit union are being achieved.

Risk management

- 11.3.58 The board shall establish, maintain and implement adequate risk management policies, and take the lead in establishing a strong risk management culture within the organisation.
- 11.3.59 The credit union shall implement a risk management process that ensures all significant risks are identified and mitigated to a level consistent with the risk tolerance of the credit union.

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- 11.3.60 The board shall document the risk tolerance of the credit union as part of the risk management process.

Internal control

- 11.3.61 The credit union shall have a robust system of internal controls that effectively manages and mitigates risk.
- 11.3.62 Credit unions shall establish and maintain effective compliance and risk management functions. The board shall appoint a compliance officer and a risk officer with the necessary authority, resources and experience to lead and manage the respective functions within the credit union.

Internal audit

- 11.3.63 The credit union shall have an internal audit function which is responsible for the evaluation of the effectiveness of the credit union's risk management, internal controls and governance processes.
- 11.3.64 The internal audit function shall be separate from other functions and activities of the credit union, and be capable of operating independently of management and without undue influence over its activities. It should report to the audit committee or, in the absence of an audit committee, to the board.

Operation of the board

- 11.3.65 The board shall meet as often as is appropriate to fulfil its responsibilities effectively and prudently, reflecting the nature, scale and complexity of the credit union. In any event, the board shall meet at least 10 times per annum, with no more than six weeks between consecutive meetings.
- 11.3.66 A detailed agenda of items for consideration and discussion shall be prepared for each board meeting.
- 11.3.67 The detailed agenda and proposed minutes of the previous board meeting shall be circulated sufficiently in advance of each board meeting to allow all directors adequate time to consider the material. Sufficient and clear supporting information and papers shall also be circulated.
- 11.3.68 Detailed minutes of all board meetings shall be prepared with all decisions, discussions and points for further action being documented. Dissensions or minority votes shall be documented in terms acceptable to the dissenting person or minority voter. The minutes of meetings shall provide sufficient detail to evidence appropriate board attention, the substance of discussions and their outcome.
- 11.3.69 All discussions related to conflicts of interests, and any actions or decisions taken as a consequence, should be recorded in detail in the board minutes.
- 11.3.70 The minutes of each board meeting shall be agreed and approved at the subsequent

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board meeting.

- 11.3.71 The creation of board agendas, the conduct of board meetings and the allocation of time to agenda items shall ensure that adequate and proportionate time is given to all material relevant matters for discussion.
- 11.3.72 Board members shall attend each board meeting unless they are unable to attend due to circumstances beyond their control. All board members' attendance and eligibility to vote at each meeting shall be evidenced in the minutes of each meeting.

Board committees

- 11.3.73 The board may delegate authority to sub-committees or to management to act on behalf of the board in respect of certain matters but, where the board does so, it shall have mechanisms in place for documenting the delegation and monitoring the exercise of delegated functions. The board cannot abrogate its responsibility for functions delegated.
- 11.3.74 The provisions of this section apply to the nomination committee and to any committee composed entirely of directors or comprising a majority of directors.
- 11.3.75 The Central Bank may determine that, due to the complexity of the business model and level of risk undertaken by the credit union, or other relevant factors, a credit union shall be required to comply with additional requirements. Where notified by the Central Bank of a requirement to do so, credit unions shall establish the following committees, all members of which shall be directors:
- audit committee
 - risk committee
 - remuneration committee
- 11.3.76 Credit unions other than those notified by the Central Bank, as described in paragraph 11.3.75, may, if the board considers it to be appropriate and proportionate, establish any committee referred to in 11.3.75. If a credit union chooses to establish such a committee, it shall adhere to the same requirements in relation to that committee as would apply if the formation of that committee were mandatory.
- 11.3.77 The board shall consider the responsibilities of each committee, document these responsibilities, and agree terms of reference.
- 11.3.78 The terms of reference of each committee, and the schedule of matters reserved for the board, shall clarify their respective responsibilities, and determine which matters can be decided by committees and which shall be approved by the board as a whole.
- 11.3.79 When appointing committee members, the board shall ensure that each committee shall collectively have an appropriate balance and sufficiency of skills and expertise, and be prepared to undertake relevant training to ensure that this requirement is met.
- 11.3.80 Each committee shall operate in a manner that is consistent with and complies with the requirements for the operation of the board as a whole, as set out in section 11.3.65.
- 11.3.81 Each committee is accountable to the board and shall, at least quarterly, prepare and

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submit to the board a formal report on their activities and deliberations.

- 11.3.82 A credit union shall also have such management committees as are appropriate to its circumstances or prescribed by law. The board shall ensure that the respective terms of reference of board and management committees are sufficiently clear to distinguish their respective roles.
- 11.3.83 Committee membership shall be managed by the board to ensure compliance with legislation and that no one individual director exercises excessive influence or control through membership of committees.
- 11.3.84 Committee members shall be subject to appointment by the board on an annual basis.

Board oversight committee

- 11.3.85 The function of the board oversight committee shall be to assess whether the board has operated as required by the governance requirements.
- 11.3.86 The board oversight committee shall:
 - i. ensure at least one board oversight committee member attends board meetings
 - ii. report to the members at the Annual General Meeting on matters referred to in section 11.3.85.
- 11.3.87 A credit union shall not permit any of the following to be a member of its board oversight committee:
 - i. an employee of that credit union or any other credit union, regardless of whether that employment is on a full or part-time basis
 - ii. a voluntary assistant of that credit union or any other credit union
 - iii. a director of that credit union or any other credit union
 - iv. a member of the board oversight committee of any other credit union
 - v. an employee of a representative body of which the credit union is a member where that employee's role could expose them to a potential conflict of interest
 - vi. an employee or board member of any public body or state agency involved in the regulation of credit unions
 - vii. an auditor of the credit union
 - viii. a solicitor or other professional advisor who has been engaged by or on behalf of the credit union within the last three years
 - ix. a member of the credit union who is in arrears for more than 90 days under a debt obligation to the credit union
 - x. a person who is a spouse, civil partner or co-habitant³³, parent or child of a director, board oversight committee member, employee or voluntary assistant of that credit union.
- 11.3.88 Each member of the board oversight committee shall have the necessary knowledge, skills, experience, expertise, personal qualities, competencies, professionalism, fitness and probity to carry out their duties and obligations.

³³ Within the meaning of the Civil Partnership and Certain Rights and Obligations of Co-habitants Act 2010.

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- 11.3.89 Having regard to paragraph 11.3.88, and in addition to any other applicable requirements, each member of the board oversight committee shall have relevant financial services expertise, qualifications and background, or be required to undertake relevant and timely comprehensive training, to a sufficient extent that they can comprehend at a minimum each of the following:
- i. the nature of the credit union's business, operating principles, activities and related risks
 - ii. their individual direct and indirect responsibilities and the board oversight committee's collective responsibilities
 - iii. the credit union's financial statements.
- 11.3.90 The board oversight committee shall ensure that each member of the board oversight committee undertakes and completes appropriate training to support the requirements above. The board oversight committee shall not allow a member of the board oversight committee to remain as a member of the committee where they fail to complete any relevant training within a reasonable time of that training being made available to them.
- 11.3.91 Board oversight committee members shall not serve on the board for more than 9 years in aggregate in any 15 year period. For existing board oversight committee members, the 9 year period commences from the date on which this regulation comes into effect.
- 11.3.92 The combined number of years a person has served on either the board or the board oversight committee may not exceed 9 years in aggregate in any 15 year period. The transitional arrangement in paragraph 11.3.91 also applies here.

11.4 Other legislative requirements

- 11.4.1 In addition to the requirements in this document, credit unions and their boards and officers are required to act in accordance with all applicable legal requirements, including, but not limited to, the 1997 Act.

11.5 Fitness & Probity

Introduction

- 11.5.1 The Interim Report of the Commission recommended that Part III of the Central Bank Reform Act 2010 be commenced for credit unions providing the Central Bank with the powers to set out the Regulations and Standards of Fitness and Probity for the credit union sector.
- 11.5.2 The Interim Report also indicated that the Commission would discuss further how the Fitness and Probity Regime should be introduced for credit unions during the second phase of its work. Arising from the recommendations contained in the Interim Report and the further work on Fitness and Probity undertaken during the second phase of the Commission, the following section describes the Fitness and Probity Regime that has been introduced for all regulated financial services providers other than credit unions and sets out the Commission's recommendations on the introduction of an

appropriate Fitness and Probity Regime for credit unions.

11.6 Central Bank Fitness & Probity Regime

11.6.1 The Central Bank fitness and probity regime currently applies to all regulated financial service providers, other than credit unions, irrespective of size, scale or complexity of the entity. This is to ensure that any individual carrying out specific types of roles are fit and proper irrespective of the size of the regulated entity.

11.6.2 The regime is based around the designation of Controlled Functions (CFs) and Pre-approval Controlled Functions (PCFs).

11.6.3 Controlled Functions (CFs)

The following functions are prescribed as CFs:

- Where performing the function enables an individual to exercise a significant influence on conduct of the affairs of the financial service provider
- Where the function is related to ensuring, controlling or monitoring compliance
- Where the function is likely to involve performing functions in a customer-facing role
- Where the function is likely to involve dealing in relation to the property of a customer or dealing in or with property on behalf of the regulated financial service provider

11.6.4 Under the existing regime, a regulated financial service provider shall not allow a person to perform a CF unless it is satisfied that the person complies with the standards of fitness and probity issued by the Central Bank and the person has agreed to abide by the standards.

11.6.5 Pre-Approval Control Functions (PCFs)

The Central Bank also has the power to prescribe a subset of CFs as Pre-approval Controlled Functions (PCFs) for which the prior approval of the Central Bank is required before a person can be appointed. The Central Bank may prescribe a CF as a PCF if the function is one by which a person may exercise a significant influence on the conduct of a regulated financial service provider's affairs.

11.6.6 As with CF's, there is an obligation on the regulated service provider to satisfy itself that a person carrying out a PCF complies with the standards of fitness and probity issued by the Central Bank. The Central Bank expects a regulated financial service provider to have conducted its own due diligence before proposing a person for appointment to a PCF.

11.6.7 The Central Bank published Statutory Instrument (SI) 437 of 2011, amended by SI 615 of 2011, (the Regulations) prescribing particular functions as CFs and PCFs.³⁴ The regulations set out 11 CFs and 41 PCFs.

11.6.8 The fitness and probity standards require that CFs and PCFs must:

³⁴ The Central Bank Act 2010 (Sections 20 & 22) Regulations 2011.

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- a) be competent and capable
- b) act honestly, ethically and with integrity
- c) be financially sound

11.7 Recommendations on Fitness and Probity for Credit Unions

- 11.7.1 The Commission recommends that Part III of the Central Bank Reform Act 2010 be commenced for credit unions providing the Central Bank with the powers to set out the Regulations and Standards of Fitness and Probity for the credit union sector. The Commission recommends that the Central Bank's fitness and probity regime should apply to credit unions with the CFs and PCFs applying to credit unions as set out below. This approach takes into account the tiered regulatory approach discussed in Chapter 7.
- 11.7.2 The Commission recommends that a phased approach is adopted for the implementation of the fitness and probity regime and that a review is undertaken following implementation of the initial phase for Type 2 and Type 3 credit unions (see Tiered Regulatory Approach – Chapter 7).
- 11.7.3 A key objective of the Commission is to bring about improved governance standards at board and management level within credit unions. Section 11.3 sets out detailed governance requirements designed to provide a framework to improve governance standards with a particular focus at board and management level. In order to remain consistent with this framework it is recommended that the fitness and probity regime for the credit union sector in the first instance will initially focus on individuals that hold board and management responsibilities within credit unions

Initial Phase

- 11.7.4 The Commission's recommendations in relation CFs and PCFs for the initial phase are as follows:

Control Functions (CFs)

- 11.7.5 All credit unions will be required to satisfy themselves that a person carrying out a CF complies with the standards of fitness and probity issued by the Central Bank and that the person has agreed to abide by the standards.
- 11.7.6 Initially, only individuals performing roles (i) with significant influence and (ii) involved in ensuring, controlling or monitoring compliance will be designated as CFs for credit unions.

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Pre-Approval Control Functions (PCFs)

- 11.7.7 As with CFs, all credit unions will be required to satisfy themselves that a person carrying out a PCF complies with the standards of fitness and probity issued by the Central Bank and that the person has agreed to abide by the standards. In addition, credit unions will be required to obtain Central Bank approval for PCFs prior to appointment.
- 11.7.8 For large credit unions it is proposed to designate the following roles as PCFs:
- all board members
 - the chair of the board
 - the chair of the nomination committee
 - the chair of the board oversight committee
 - the manager
- 11.7.9 For all other credit unions, only the positions of chair of the board and manager would be designated as PCFs. Other board members, members of the nomination committee and members of the board oversight committee, along with any other individuals performing roles with significant influence and roles involved in ensuring, controlling or monitoring compliance will continue to be CFs with the associated responsibility on the credit union to ensure that they comply with the standards of fitness and probity issued by the Central Bank.

Implementation Approach for Initial Phase

- 11.7.10 The Commission believes that transitional arrangements for the implementation of a fitness and probity regime for credit unions are important to ensure that credit unions are given adequate time to put the necessary policies and procedures in place to implement the regime.
- 11.7.11 The Commission recommends that the same approach should be adopted for PCFs as applies in the existing regime for all other regulated financial service providers i.e. in situ PCFs will not be required to go through the pre-approval process for their existing positions, however they will be subject to the standards of fitness and probity.

Election to Posts that are PCFs or CFs

- 11.7.12 As described above under the Fitness and Probity regime introduced on 1 December 2011, all regulated financial service providers are required to conduct due diligence before proposing a person for appointment to a PCF and all appointments to PCFs require the prior written approval of the Central Bank. Additionally regulated financial service providers shall not allow a person to perform a CF unless it is satisfied that the person complies with the standards of fitness and probity issued by the Central Bank and the person has agreed to abide by the standards.
- 11.7.13 Therefore, a person may not perform a PCF following election at an AGM or special general meeting unless and until they are approved by the Central Bank, as is the case in the existing Fitness and Probity regime. Similarly, a person may not perform a CF following election at an AGM or special general meeting, unless the credit union is satisfied that they comply with the standards of fitness and probity and the person

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has agreed to abide by the standards. Accordingly, the Commission recommends that the nominations process should be formalised so that directors' nominations are channelled through a statutory nominations committee and, where required, submitted to the Central Bank for approval in advance of the AGM or special general meeting. It is also recommended that the current nominations process is changed so that a person may no longer be nominated from the floor at an AGM or special general meeting.

11.8 Minimum Competency Requirements

- 11.8.1 The Commission's Interim Report noted that the governance of credit unions could be improved through the appointment of officers with specific expertise in key areas of the credit union.
- 11.8.2 The Interim Report recommended that the Central Bank be provided with the powers to set out a Minimum Competency Code for the credit union sector that would take account of the voluntary ethos of credit unions.
- 11.8.3 The Interim Report also suggested that all directors, following their election or re-election to the board of a credit union, should be required to undertake training to provide them with a clear understanding of their significant responsibilities as a credit union director, that all credit union officers should undergo ongoing training and up-skilling and that all directors should be required to undertake a minimum number of formal training hours each year.^{xxxiv}
- 11.8.4 The Commission notes that a number of requirements in relation to competency and training for directors, managers and the board oversight committee are contained in the governance requirements set out above.
- 11.8.5 The Commission recommends that consideration be given to developing a wider minimum competency code for credit unions following implementation of the governance requirements and fitness and probity regime for credit unions recommended in this Chapter.

Chapter 12 – Conclusion

12.1 Conclusion

- 12.1.1 The credit union sector in Ireland plays a crucial role in helping to meet the financial, economic and social needs of many people. Recent adverse financial and economic conditions in Ireland, allied with internal governance weaknesses in some credit unions and the absence of an appropriate statutory regulatory framework, have contributed to the significant issues facing the sector. However, while the challenges are significant, they are not insurmountable. A strengthened and revitalised sector can be in a position to play an increasing role in the retail financial landscape of the future.
- 12.1.2 The recommendations in this Report are the outcome of the Commission's deliberations over a period of nine months. The consultation process and the credit union survey helped to bring a broader range of insights to the discussion. The examination of other credit union movements and academic research has enabled the Commission to ground its recommendations in real world evidence and experience.
- 12.1.3 The Government has committed to publishing a Credit Union Bill by the end of June 2012. This is also a structural benchmark under the EU-IMF Programme. The Commission process has enabled proposals across a range of areas — stabilisation, prudential requirements, governance, restructuring, legislative change — to be examined carefully and in an open and participative way. The Commission believes that the time and effort taken to do this will ultimately enhance the effectiveness and durability of the resulting legislation.
- 12.1.4 The Commission believes that it is important that the changes set out in this report are implemented and recommends that an implementation group be established to monitor and advise the Minister for Finance on progress.

This Report does not impact on the independence of the Central Bank of Ireland in the performance of its statutory functions and this Report is without prejudice to the performance by the Central Bank of Ireland of its statutory functions.

Appendices

Appendix 1 – Commission on Credit Unions -Terms of Reference

Having regard to the commitments

- in the Programme for National Government 2011-2016 to review the future of the credit union movement and to make recommendations in relation to the most effective regulatory structure for credit unions, and
- under the EU/IMF Programme of Support for Ireland to design a strategy for the future evolution of the credit union sector, to assist credit unions with a strengthened regulatory framework including more effective governance and regulatory requirements and to make recommendations to the Minister on legislation to be submitted to the Oireachtas by end-2011; and

taking into account

- the not-for-profit mandate of credit unions, their volunteer ethos and community focus, paying due regard to the need to fully protect depositors' savings and financial stability,
- the comprehensive strategy to enhance the viability of the credit union sector prepared under the EU/IMF Programme of Support for Ireland;
- international best practice in the structure, organisation and regulation of credit unions or analogous entities; and
- the strengths and weaknesses of the sector as set out in work done in the Strategic Review of the Credit Union Sector in Ireland;

the Commission on Credit Unions is invited to:

1. **Define the role of credit unions in the context of a restructured financial services sector.** This will focus on the credit union as a co-operative, owned and run by its members and providing its members with the financial services that they require. Consideration will also be given to the role of the credit union in relation to the community in general. In particular, the objects of a credit union as set out under section 6 of the Credit Union Act 1997 will be examined including the function of the common bond in the context of modern financial services systems. The Commission should also consider the question of the prudential supervision of loan societies and credit co-operatives registered under the Friendly Societies Act 1896 and the Industrial and Provident Societies Act 1893 that engage in taking deposits from and providing loans to their members and make recommendations in this regard.
2. **Propose a model for modern credit unions and define the structure/parameters** within which financially viable credit unions will operate. At the same time, the Commission will examine how credit unions may continue to provide the services required by their members while meeting regulatory requirements sufficient to protect the savings of depositors and the financial stability of the credit union sector as a whole. This should examine how the size of a credit union, the variety and complexity of the services it provides and the competencies of its

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management and staff influence its viability. The question of credit unions competing with the larger financial institutions should be studied.

3. **Options for restructuring** The Commission will make recommendations on the possibility of voluntary consolidation or restructuring of the credit union sector over time, recognising the need to maintain local presence and taking into account the not-for-profit mandate, the volunteer ethos and community focus of credit unions. In this consideration, due regard must be given to the need to protect depositors' savings and financial stability. Central Bank of Ireland proposals in relation to possible restructuring of some credit unions should be examined and recommendations made to the Minister for Finance as these may arise over the term of the Commission. The Commission is required to engage with the Department of Finance, make recommendations and exchange information on legislative proposals during the course of its deliberations.
4. **Shared services** The Commission will examine the options for groups of credit unions to share services on a formal basis and the extent to which this model is appropriate. The Commission should consider which services are most suitable for delivery by a separate entity, e.g. purchasing, auditing, compliance, credit control, legal, marketing, human resource management, administration and training. Progress in relation to the introduction of modern information technology and management information systems for and in credit unions will be examined and recommendations made in this regard.
5. **Determine and set out the basic governance and regulatory requirements that must be met.** The Commission will focus on a set of benchmarks that credit unions should meet if they are to be registered to operate in the State. These benchmarks should include capital requirements, sizes of loan books and of loans, competencies of directors and staff, investments policy, fitness and probity and governance standards. Recommendations will be made in relation to management reporting arrangements both internally and with the Registry of Credit Unions.
6. **Make recommendations for legislative change.** The Commission will examine the existing legislation and in particular the Credit Union Act 1997 and make recommendations on changes required to implement their findings. The Commission should make initial recommendations required to strengthen the regulatory framework of credit unions by 30 September 2011. A final report should be submitted to the Minister for Finance by 31 March 2012.

Appendix 2 - Public Consultation Request July 2011

The Government has established a Commission on Credit Unions.

The Commission is to review the future of the credit union movement and make recommendations in relation to the most effective regulatory structure for credit unions. This review will take into account their not-for-profit mandate, their volunteer ethos and community focus, while paying due regard to the need to fully protect depositors savings and financial stability. A copy of Commission's Terms of Reference is available on the Department of Finance's website:

<http://www.finance.gov.ie/documents/publications/reports/2011/creditunion.pdf>

The Commission on Credit Unions is seeking views on the following:

- (i) Given the present restructuring of the financial services sector in Ireland how might the role currently discharged by credit unions change in terms of, for example, service provision and support to local communities?
- (ii) Is the present credit union operating model appropriate for the Irish movement in the future? If changes are required what form should they take?
- (iii) Recognising the need to maintain a local presence and taking into account the not-for-profit mandate, the volunteer ethos and community focus of credit unions is there a need for credit union consolidation and / or restructuring? If so, how might this be achieved?
- (iv) What are your views on modern information technology and management information systems for and in credit unions as currently implemented? What changes are required?
- (v) Is it appropriate for credit unions to share services on a formal basis and, if so, how might this be implemented? Which services (and why) are most suitable for delivery on a shared basis?
- (vi) What are your views on governance standards within the credit union movement? What changes are required?
- (vii) What are your views on the regulatory requirements presently placed on credit unions? What changes are required?
- (viii) What are your views of the role of credit unions in the support of financial inclusion?
- (ix) What are your views on existing legislation and in particular the Credit Union Act 1997? What changes are required?

More generally, the Commission welcomes contributions (over and above those sought in the questions above) that will facilitate the good functioning of the Irish credit union movement in the future. Contributions on all or some of the above can be submitted by post or email to:

Secretary to the Commission on Credit Unions, Commission on Credit Unions,
Department of Finance, South Block, Government Buildings, Dublin 2.

CCU.Submissions@ccu.gov.ie. Submissions should be made by 25 August, 2011.

In making a submission, please state if the views expressed are personal or are being made on behalf of an organisation. If views of an organisation are being submitted, it should be made clear which organisation is represented. Submissions will be subject to the provisions of the Freedom of Information Acts. Except where it is indicated that the submission is to remain confidential, submissions will be published on the Department of Finance website.

Appendix 3 – List of Consultation Submissions

| Submissions from credit unions | |
|---|---|
| An Post Employees' Credit Union Ltd | North Side Credit Unions |
| ASTI Credit Union Limited | Oldcastle Credit Union Limited |
| Athboy Credit Union Limited | Rathmore and District Credit Union Limited |
| Athenry Credit Union Limited | Sallynoggin/Glenageary Credit Union Limited |
| Athlone Credit Union Limited | Sandymount Credit Union Limited |
| Balbriggan Credit Union Limited | Slane Credit Union Limited |
| Ballina Credit Union Limited | Duleek Credit Union Limited |
| Ballinamore Credit Union Limited | Dundrum Credit Union Limited |
| Ballinasloe Credit Union (Or Lady of Lourdes) Limited | East Meath Credit Union Limited |
| Ballincollig Credit Union Limited | Fairview Credit Union Limited |
| Ballivor/Kildalkey Credit Union Limited | Farranree Credit Union Limited |
| Ballyconnell Credit Union Limited | Glenamaddy Credit Union Limited |
| Ballymote & District Credit Union Limited | Gorey Credit Union Limited |
| Ballyphehane Credit Union Limited | Gurranbraher Credit Union Limited |
| Ballyshannon Credit Union Limited | IndoGroup Credit Union Limited |
| Banagher Credit Union Limited | Kilnamanagh Credit Union Limited |
| Bishopstown Credit Union Limited | Kiltimagh Credit Union Limited |
| Blanchardstown & District Credit Union Limited | Kinnegad & District Credit Union Limited |
| Bray Credit Union Limited | Larkhill & District Credit Union Limited |
| Castlerea & District Credit Union Limited | Longford Credit Union Limited |
| Cathedral Credit Union Limited | Mallow Credit Union Limited |
| Clonmel Credit Union Limited | Maynooth Credit Union Limited |
| Clontarf Credit Union Limited | Monasteravin Credit Union Limited |
| Comhar Linn INTO, Dubco and Health Services Staffs Credit Union | Naas Credit Union Limited |
| Dalkey Credit Union Limited | North Longford & Arva Credit Union Limited |
| Duleek Credit Union Limited | North Side Credit Unions |
| Dundrum Credit Union Limited | Oldcastle Credit Union Limited |
| East Meath Credit Union Limited | Rathmore and District Credit Union Limited |
| Fairview Credit Union Limited | Sallynoggin/Glenageary Credit Union Limited |
| Farranree Credit Union Limited | Sandymount Credit Union Limited |
| Glenamaddy Credit Union Limited | Slane Credit Union Limited |
| Gorey Credit Union Limited | St. Colmcille's (Kells) Credit Union Limited |
| Gurranabraher Credit Union Limited | St. Anthony's & Claddagh Credit Union Limited |

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| | |
|--|--|
| IndoGroup Credit Union Limited | St. Brigid's Credit Union Limited |
| Kilnamanagh Credit Union Limited | St. Columba's Credit Union Limited |
| Kiltimagh Credit Union Limited | St. Francis Credit Union Limited |
| Kinnegad & District Credit Union Limited | St. Gabriel's Credit Union Limited |
| Larkhill & District Credit Union Limited | St. Jarlath's Credit Union Limited |
| Longford Credit Union Limited | St. Patrick's (ESB) Credit Union Limited |
| Mallow Credit Union Limited | St. Raphael's Garda Credit Union Limited |
| Maynooth Credit Union Limited | The Lough Credit Union Limited |
| Monasterevan Credit Union Limited | Thurles Credit Union Limited |
| Naas Credit Union Limited | Tralee Credit Union Limited |
| North Longford & Arva Credit Union Limited | Westport Credit Union Limited |
| Non-credit union submissions | |
| An Post | IBF (Irish Banking Federation) |
| Annette Kiely | Irish Association of Older People |
| Henry Bauress | Irish Council for Social Housing |
| Bayberry Consulting Ltd | Irish Credit Bureau Limited |
| BNP PARIBAS Corporate & Investment Banking | IS Options |
| Capital Loan & Investment Society | Mary T Lane |
| Anthony Carroll | John Maher |
| Centre for Co-operative Studies | MABS |
| Chapter 5 Credit Unions | MasterCard Worldwide |
| Chapter 6 Credit Unions | Mayoplus |
| Chapter 13 Credit Unions | Bernie Morrissey |
| Chapter 15 Credit Unions | Timothy Murphy |
| John A Connolly | NABCO |
| Michael Corcoran | National Financial abuse of Older People Working Group |
| Credit Union Alliance | New Ireland Assurance |
| Credit Union Technology Suppliers Forum (CUTSF) | Northside Community Law Centre |
| CRM Limited | Jim O'Connell PC |
| CUDA | O'Donovan Associates Management Consultants |
| CUMA | Jean O'Hara |
| CUNA Mutual | Clair O'Reilly, O'Reilly Consulting |
| CUNA Mutual Group USA | John O'Riordan |
| DCR Strategies Inc. | Pallas Computer Systems Limited |
| The Dormant Accounts Board | Michael Ryan |
| Enterprise IT Ltd | Pat O'Donnell & Tom Ryan |
| Fexco | SIPTU |
| Grant Thornton, ICE Computer Services and IS Options | Seamas Watters |
| Bill Hobbs | Wellington IT Solutions |
| Mark Hussey | World Council of Credit Unions |

Appendix 4 – Efficiency Study

Professor Donal McKillop and Barry Quinn³⁵

Introduction

This study investigates Irish credit union performance over the period 2002 to 2010. The empirical analysis uses a two-stage approach. The first stage measures efficiency by a data envelopment analysis (DEA) estimator, which explicitly incorporates the production of *undesirable* outputs such as bad loans in the modelling process. In modelling the productive process of credit unions, each credit union is viewed as employing a set of inputs (capital expenditure, labour expenditure and interest paid on deposits and dividends paid on shares) to produce a set of *desirable* outputs such as various types of loans and investments as well as shares and deposits. Unfortunately some loans and investments turn out to be ‘bad’ loans and ‘bad’ investments which must be written off as bad debt. Producer-specific performance measures which permit credit unions to be credited for the reduction of *undesirable* outputs as well as for increasing *desirable* outputs and decreasing inputs are thus obtained³⁶. The performance measure (efficiency score) obtained for each credit union ranges from 0 (highly inefficient in transforming inputs into outputs) to 1 (highly efficient in transforming inputs into outputs). In the second stage of the analysis how certain factors influence the efficiency scores of credit unions is examined. Factors that prove important are capital strength, liquidity, asset size and common bond type.

A feature of the Irish credit union landscape in recent times is an increased focus upon regulatory compliance. Indeed a critical element in the successful development and good functioning of a credit union movement is that it has appropriate regulatory and supervisory infrastructures. The regulatory infrastructure contextualises the *modus operandi* of credit unions while the supervisory framework ensures the financial soundness and rectitude of individual credit unions and, in so doing, safeguards the movement as a whole. One facet of regulatory and supervisory control is that credit unions are encouraged to minimize incidence of bad debt on loans and investments. Inevitably, some credit unions find it more difficult than others to avoid excessive production of bad debt. This means that the latter credit unions face a greater opportunity cost, in terms of lower production of *desirable* outputs and/or higher input requirement, as they direct resources to prevent the excessive production of bad debt. Our model obtains empirical estimates of the opportunity cost of credit unions endeavouring to minimise bad debt exposure.

The format of the analysis is as follows. In the next section an overview of efficiency studies on credit unions is detailed. The methodology and data upon

³⁵ Donal McKillop is Professor of Financial Services at Queen’s University Belfast. Barry Quinn is lecturer in finance at Queen’s University Belfast

³⁶ For a pioneering application of this approach to banking, see Park and Weber (2006).

which the analysis is based is then summarised. The study concludes by presenting the empirical findings with supporting discussion.

Efficiency Studies

There is an extensive empirical literature on the measurement of cost structure and efficiency in the financial services industry. In contrasting the volume of work on banks with that on mutual financial services organisations, Worthington (2010, p.39-40) states:

“In the main, the substantive part of this research has focused on medium-to-large deposit-taking institutions [however], the need to understand issues of efficiency and productivity is no less pronounced in financial mutuals with the important role this information can provide in assessing the impact of regulation and yielding insights into the process of organisational and structural change characteristic of recent decades.”

Early studies in this area use either ratio analysis or simple production and cost functions to assess performance. One of the first studies to assess the performance of credit unions is that by Croteau (1956). This study utilises financial ratio analysis to suggest that US credit unions are characterised by increasing returns to scale. Similar findings (based upon the Cobb-Douglas production function) are obtained for US credit unions by Dran (1971), Taylor (1972 and 1977), Wolken and Navratil (1980) and Fry et al. (1982). Later studies on US credit unions by Kohers and Mullis (1987 and 1988) and Cox and Whigham (1984) (using index-based financial ratios) find (with the exception of Cox and Whigham who find constant returns to scale) that the sector is characterised by increasing returns to scale.

Studies for other countries yield much less unanimity with respect to scale returns. Esho (2000), using a multi-product translog function, finds increasing returns to scale. It is interesting to note that Esho (2000) allows for subsidies in kind, while the prior studies do not. This may well explain the finding of decreasing returns to scale in earlier studies. For Canada, Murray and White (1983) and Kim (1986) each use a multi-product translog function and both find slight increasing returns to scale. Sibbald and McAlevey (2003) find that credit unions in New Zealand experience returns that are increasing up to a certain size threshold and thereafter decreasing.

The general picture that emerges from these early studies is that credit union movements in most countries are characterised by increasing returns to scale. This provides a justification for growth strategies pursued by credit unions (either internally generated or via merger and acquisition) and for regulation permitting expansion of the common bond.

More recently credit union performance (efficiency) has been assessed employing frontier efficiency measurement based upon parametric and non-parametric techniques. The empirical measurement of economic efficiency centres on determining the extent of either allocative efficiency (the ability of an organisation to use its inputs in optimal proportions, given their prices and the

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production technology) or technical efficiency (the ability to use resources in the most technologically efficient manner) or both in a given organisation or industry. Having determined the level and type of efficiency the empirical studies then seek to determine the extent to which: firm-specific (asset size, capital strength, liquidity, product profile, common bond type); sectoral (regulatory body, trade association affiliation); and geographic (rural/urban location, socio-economic membership mix) factors impact upon estimated efficiencies.

For Australia, Worthington (1998) analyses 150 credit unions for the year 1995. He notes that large well capitalised credit unions with small branch networks are more efficient. Esho (2001) analysing 80 credit unions located in New South Wales notes that there is little improvement in average efficiency over the period 1985 to 1993. Furthermore cost efficiency is positively correlated with average loan size and capital strength. No significant relationship emerges between asset size and efficiency. Brown et al. (1999) analyse Australian credit unions located in the state of Victoria for the period 1992 to 1995. They find no evidence that the average credit union moved closer to the efficient frontier.

For the US, Fried et al. (1993) highlights that there are a large number of best-practice credit unions with influences on efficiency traced to locational and institutional characteristics. Fried et al. (1996) evaluate the performance of university-affiliated credit unions and compare their performance with that of other credit unions. They find support for the hypothesis that university-affiliated credit unions, by virtue of the higher educational attainment of their membership, some of whom sit on the board of directors that oversees management, operate more efficiently than other credit unions. Frame and Coelli (2001) employ a stochastic cost frontier to investigate US corporate credit unions for the period 1992-1997. They find that 91% are cost efficient, with those credit unions investing a greater proportion of their assets in a centralised fund (US Central Credit Union) being most efficient. Furthermore, cost efficiency declines after the imposition of safety and soundness measures introduced by the regulator in 1995.

Wheelock and Wilson (2009) use a new distance function to define and measure cost productivity, and to define components of the cost productivity index. The authors find that US credit unions experience decreasing cost productivity between 1989 and 2006 with smaller credit unions experiencing greater declines than their larger counterparts. The authors contend that the results are consistent with the view that recent changes in regulation and technology have tended to favour larger credit unions. Wheelock and Wilson (2011) use a non-parametric local-linear estimator to estimate a cost relationship for credit unions and find evidence of increasing returns to scale over the period 1989-2006. They conclude that further deregulation which allows credit unions to expand their scale or scope of activities will lead to further increases in size and improvements in efficiency.

For the UK, McKillop et al. (2002) use DEA to obtain radial and non-radial efficiency measures while McKillop et al. (2005) use a stochastic frontier analysis to evaluate the relative performance for the period 1991 to 2001. The results of both studies suggest that UK credit unions have considerable scope for

efficiency gains. These studies also suggest that credit unions suffer from a considerable degree of scale inefficiency with in excess of 50 percent of scale inefficient credit unions subject to decreasing returns to scale.

Overall, there is less consistency in the observed findings for frontier based studies relative to the earlier production function and ratio based studies. Efficiency is influenced by an extensive range of factors, and the observed findings depend upon both the methodological approach utilised and the geographical area investigated. This is unsurprising given that the regulatory environment and maturity of credit unions differs between countries. Finally, while a small number of studies find a positive impact of size on efficiency, the remaining (majority) find little evidence of an empirical relation.

Methodology and Data

Methodology

A comprehensive analysis is undertaken by using a non-parametric (hyperbolic DEA estimator) techniques to estimate efficiency scores (Fare et al. 1989; Ray 2004). The hyperbolic model allows the asymmetric treatment of *desirable* and *undesirable* outputs such that credit unions can have a positive level of *desirable* output with the possibility of zero levels of *undesirable* outputs³⁷. Given a set of inputs it measures the performance of a credit union by rewarding it for a simultaneous reduction in its *undesirable* outputs while increasing its good outputs in an asymmetric manner.

Furthermore the model allows the identification of those credit unions that suffer an opportunity cost in terms of regulatory compliance to reduce *undesirable* output. This is achieved by applying the weak disposability assumption to the *undesirable* outputs. This means that if both *desirable* and *undesirable* outputs are jointly produced, the *undesirable* outputs cannot be disposed without the additional cost of reallocation of credit unions inputs away from the production of good outputs. (Fare and Grosskopf, 2004).

Non-parametric techniques are deterministic in nature which makes statistical meaning difficult. Also relative efficiency scores measured in this manner may include bias inherent in the data. To this end we use Simar and Wilson (1998) bootstrapping technique to account for any bias and create bias corrected estimates which we can use to investigate the factors that drive efficiency and the opportunity cost of regulatory compliance. In the case of the former we use the bias corrected estimates to estimate a truncated regression using algorithm 1 from Simar and Wilson (2008). This allows valid inference from any statistical relationships that are identified. While in the case of the latter an estimate of the differential impact on a credit union of regulatory compliance can be obtained by comparing a credit union's bias corrected efficiency score under the assumptions of weak and strong disposability of *undesirable* outputs, respectively (see for example, Färe et al (1989)).

³⁷ An alternative approach to dealing with undesirables proposed by Fare and Grosskopf (2004) using the directional distance function to model production. This requires both desirables and undesirables to be null joint (i.e. at least one undesirable output must be produced for every observations having at least one desirable output)

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Data

The data upon which the analysis is based comes from a variety of sources. Financial data on credit unions affiliated to the Irish League of Credit Unions (ILCU) was provided by that representative body, for other credit unions the information was obtained from paper-based copies of their annual returns which were supplied by credit unions on a case-by-case basis and by the credit union regulator. A nine year period is analysed, 2002 to 2010. There are a number of incomplete records for 2010. The study is based on 3,250 input and output combinations over the nine year period.

Empirical Findings

How efficient are Irish credit unions?

Efficiency analysis produces quantitative measures that are objectively determined independent of the influences of market forces and other external factors that sometimes skew more traditional performance indicators.

From Table 1 the geometric average bias corrected efficiency value for Irish credit unions as a whole was calculated at approximately 0.73. What does this mean? In getting this empirical evaluation of productive performance, the model has the property of crediting credit unions for bad loans reduction as well as for *desirable* output expansion given a set of inputs. Therefore the average efficiency value of 0.73 suggests that if the 'average' credit union in the sector were in a position to emulate those credit unions identified as most efficient, that is if it were able to put in place the systems and structures of the best performing credit unions, then it could improve its performance by expanding its *desirable* outputs (loans, investments and shares and deposits) by 37% ($1/0.73 = 1.37$), while simultaneously contracting its *undesirable* output (bad debts) by 27% ($1 - 0.73 = 0.27$).

Table 1 Efficiency Scores

| Table 1: Efficiency Scores | | |
|----------------------------|-------------------|----------------------------------|
| | Efficiency scores | Bias-corrected Efficiency scores |
| Sample size | 3,250 | 3,250 |
| Minimum | 0.565 | 0.470 |
| Maximum | 1.0 | 1.17 |
| Median | 0.775 | 0.728 |
| Geometric Mean | 0.783 | 0.730 |
| Skewness | 0.49 | 0.49 |
| Kurtosis | 2.81 | 3.21 |

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What drives efficiency?

Using regression analysis a number of factors were identified as having a significant influence on efficiency (see Table 2). First, credit unions that can be categorised as occupational or associational are more efficient than their community based counterparts. The better performance of occupational/associational credit unions is in part influenced by the fact that the majority of their members are in salaried employment, whereas community credit unions may have a proportion of unemployed members. For certain occupational/associational credit unions there may also be some hidden ‘in kind’ advantages, for example many occupational/associational credit unions not only operate direct payroll deduction of loan repayments but also have a savings plan linked to salary.

Table 2 Factors Influencing Performance

| Table 2: Factors Influencing Performance | | | |
|--|------------------------|----------|----------|
| Regressor Variables | Estimated coefficients | Lower 5% | Upper 5% |
| Capital ratio | 0.199*** | 0.18 | 0.25 |
| Liquidity ratio | 0.051*** | 0.48 | 0.73 |
| Surplus funds/asset ratio | -0.0623 | -0.04 | 0.18 |
| Dividend rate | -0.0547 | -0.03 | 0.12 |
| Asset size | 0.415** | 0.36 | 0.62 |
| Asset size squared | -0.121*** | -0.10 | -0.13 |
| Occupational dummy | 0.041*** | 0.027 | 0.054 |
| Time trend | -0.015*** | -0.016 | -0.013 |

(i) The regressand is the bootstrap-based bias-corrected DEA estimate of the unobserved efficiency score of each credit union. A positive estimated coefficient implies that an increase in the explanatory factor increases efficiency.

(ii) ***, **, * denote significance from zero at the 1%, 5% and 10% levels using the bootstrap-estimated confidence intervals.

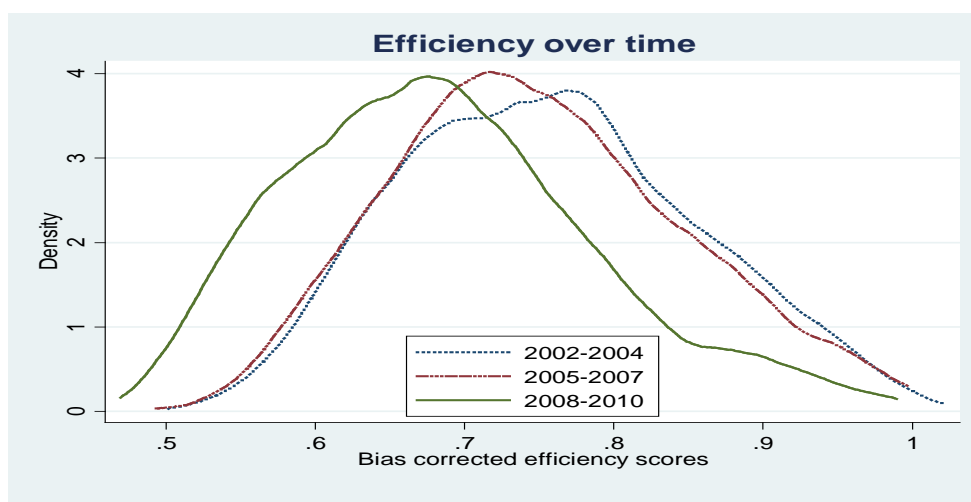
(iii) The truncated regression estimation with bootstrap is based on Simar and Wilson (2007), Algorithm 1, using 1,000 bootstrap replications for the confidence intervals of the estimated truncated regression coefficients.

Second, the asset size of a credit union improves efficiency up to an optimal level (this can be seen from the significant quadratic relationship that exists, with the coefficient of the square of asset size being negative and statistically significant). This may be indicative of the fact that up to a certain size there are scale and scope economies to be achieved. To explore the relationship between size and efficiency further we analysed the distribution of efficiency scores relative to asset size for credit unions in five size bands (less than €20 million, €20million to less than €40million, €40 million to less than €60million, €60 million to less than €100 million and greater than €100 million). The key result to emerge was that credit unions with assets in excess of €100m are much more efficient on average than those in the other size categories.

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Third, better capitalised credit unions were more efficient. Again it is interesting to explore this finding in more detail. Consequently we analysed the distribution of the efficiency scores for credit unions that fell beneath regulatory capital guidelines over the period against those that met the capital requirements³⁸. The analysis demonstrated that those credit unions meeting capital requirements are on average more efficient than their undercapitalized counterparts.

Fourth, the information in Table 2 suggests that credit unions with higher liquidity levels are more efficient. Finally, we found deterioration in efficiency levels over the period 2002-2010, the time trend in Table 2 is negative and significant suggesting that over the period Irish credit unions have become less efficient, a result not unexpected given the adverse economic conditions post 2007. To explore this further we present a diagrammatic representation of the distribution of efficiency scores for three time periods 2002 to 2004, 2005 to 2007 and 2008 to 2010. The diagram below clearly demonstrates that the average efficiency scores deteriorated significantly in the 2008 to 2010 time frame.



As noted earlier an estimate of the impact of bad debt compliance on credit union performance can be obtained by comparing a producer's bias-corrected efficiency score under the assumptions of weak and strong disposability of *undesirable* outputs, respectively. In the first instance 44% of credit unions faced an extra specific opportunity cost in endeavouring to keep bad debts as low as possible. This implies that these credit unions are subject to an opportunity cost, in terms of lower production of *desirable* outputs and/or higher input requirements, as they divert input resources to meet any bad debt requirements. A comparison of some characteristics of credit unions which face a specific extra opportunity cost in meeting bad debt reductions with those that do not suggests that the former group tend to be smaller, less liquid and have a lower capital ratio.

³⁸ Prior to 2008, the reserve requirement was 8% with this increasing to 10% after 2008.

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Summary Comments

The present study assesses the relative performance of Irish credit unions in terms of a two stage empirical investigation. The first stage measures efficiency by a DEA estimator, which explicitly incorporates the production of *undesirable* outputs such as bad loans and investments and the second stage uses truncated regression to infer how various factors influence the (bias-corrected) estimated efficiency. The study also addressed the impact of any requirements designed to discourage the production of excessive amounts of bad outputs. A key finding is that over the period 2002 to 2010 there is considerable variation in performance (efficiency) between credit unions. The analysis enables us to answer the question of how the performance of individual credit unions could be improved if these credit unions were in a position to put in place the structures and capabilities of the best performing credit unions in the sector. The analysis reveals that the average credit union could improve its performance by expanding its *desirable* outputs by 37% while simultaneously contracting its *undesirable* output by 27%.

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Appendix 5 - Credit Union Operating Principles

Statement of Credit Union Operating Principles as adopted at the Annual General Meeting of the Irish League of Credit Unions 1984.

Introduction

These Credit Union Operating Principles are founded in the philosophy of co-operation and its central values of equality, equity and mutual self-help. At the heart of these principles is the concept of human development and the brotherhood of man expressed through people working together to achieve a better life for themselves and their children.

1 Open and voluntary membership

Membership in a credit union is voluntary and open to all within the accepted common bond of association that can make use of its services and are willing to accept the corresponding responsibilities.

2 Democratic control

Credit union members enjoy equal rights to vote (one member, one vote) and participate in decisions affecting the credit union, without regard to the amount of savings or deposits or the volume of business. The credit union is autonomous, within the framework of law and regulation, recognising the credit union as a co-operative enterprise serving and controlled by its members. Credit union elected officers are voluntary in nature and incumbents should not receive a salary for fulfilling the duties for which they were elected. However, credit unions may reimburse legitimate expenses incurred by elected officials.

3 Limited Dividends on equity capital

Permanent equity capital where it exists in the credit union receives limited dividends.

4 Return on savings and deposits

To encourage thrift through savings and thus to provide loans and other member services, a fair rate of interest is paid on savings and deposits, within the capability of the credit union.

5 Return of surplus to members

The surplus arising out of the operations of the credit union after ensuring appropriate reserve levels and after payment of dividends belongs to and benefits all members with no member or group of members benefiting to the detriment of others. This surplus may be distributed among members in proportion to their transactions with the credit union (interest or patronage refunds) or directed to improved or additional services required by the members. Expenditure in credit unions should be for the benefit of all members with no member or group of members benefiting to the detriment of others.

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6 Non-discrimination in race, religion and politics

Credit unions are non - discriminatory in relation to race, nationality, sex, religion and politics within the limits of their legal common bond. Operating decisions and the conduct of business are based on member needs, economic factors and sound management principles. While credit unions are apolitical and will not become aligned with partisan political interests, this does not prevent or restrict them from making such political representations as are necessary to defend and promote the collective interests of credit unions and their members.

7 Service to Members

Credit union services are directed towards improving the economic and social well-being of all members, whose needs shall be a permanent and paramount consideration, rather than towards the maximising of surpluses.

8 Ongoing Education

Credit unions actively promote the education of their members, officers and employees, along with the public in general, in the economic, social, democratic and mutual self-help principles of credit unions. The promotion of thrift and the wise use of credit, as well as education on the rights and responsibilities of members are essential to the dual social and economic character of credit unions in serving member needs.

9 Co-operation among co-operatives

In keeping with their philosophy and the pooling practices of co-operatives, credit unions within their capability actively co-operate with other credit unions, co-operatives and their associations at local, national and international levels in order to best serve the interests of their members and their community. This inter-co-operation fosters the development of the co-operative sector in society.

10 Social responsibility

Continuing the ideals and beliefs of co-operative pioneers, credit unions seek to bring about human and social development. Their vision of social justice extends both to the individual members and to the larger community in which they work and reside. The credit union ideal is to extend services to all who need and can use it. Every person is either a member or a potential member and appropriately part of the credit union sphere of interest and concern. Decisions should be taken with full regard for the interests of the broader community within which the credit union and its members reside.

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Endnotes

ⁱ It could be argued that it has been the drive to maximise shareholder value and director bonuses which has encouraged other financial institutions to engage in risky investment and unsafe lending practices resulting in the present financial turmoil. Brunnermeier (2009) provides an excellent overview of the crisis.

ⁱⁱ Credit unions may provide a competitive discipline to mainstream financial institutions in local markets for financial services, and may mitigate against the abuse of market power by large banks. Evidence from the US suggests that banks offer higher deposit rates in markets where there is a significant credit union presence (Togle and Togle, 2000; Hannan, 2003). No comparative evidence is available for Ireland. However, competition assessments of the highly concentrated retail banking market in Ireland suggest that there are significant demand and supply side barriers to competition (Competition Authority, 2005). These barriers are not likely to have declined since the onset of the financial crisis, and the exit of foreign banks (including Bank of Scotland (Ireland)) from the sector.

ⁱⁱⁱ This classification typology was developed by Ferguson and McKillop (1997, 2000).

^{iv} MacPherson (1998, 1999) also partitions the dynamics of credit unions into three stages of development: (1) the formative stage, (2) the national stage and (3) the international stage as does Richardson (2000a, 200b). The latter views the three distinct phases to be characterised by dependence and poor image in the first phase, independence and good image in the second, and interdependence and excellent image in the final phase.

^v McKillop et al. (2006: 66-68) note that this penetration rate is likely to be an overestimation as people may be members of more than one credit union. For instance, in Offaly and Monaghan, the number of members of credit unions in both counties is greater than the population of each county.

^{vi} Demutualisation is not necessarily a bad outcome if the economic and social functions which credit unions originally evolved to provide are now provided efficiently and effectively by other suppliers (or if the evolution of credit unions has taken their focus away from their original social objectives). Even if this is the case, demutualisation involves significant wealth redistribution, and thus warrants attention. Davis (2001 and 2007) summarises many of the theoretical arguments for and against credit union demutualisation using as a backdrop Australian credit unions.

^{vii} Power, C., O'Connor, R., McCarthy, O. and Ward, M (2011) present an edited work on the *origins, ethos and evolution of co-operative credit in Ireland. This work celebrates the centenary of the birth of Nora Herlihy.*

^{viii} The name Irish League of Credit Unions was adopted in 1972.

^{ix} Rick (1998) details six reasons why mergers have occurred in US credit unions: (i) Deregulation is forcing credit unions to consolidate to remain competitive. Regulatory change has broken down the barriers and functional distinctions that once separated the activities of banks, insurance companies and credit unions. Many credit unions in the face of this competition decide that the best thing they can do to remain viable is to find a merger partner. The merger then allows credit unions to combine resources to achieve the critical mass which will enable them to make other strategic alliances. (ii) The increase in regulatory burdens and the resulting costs of compliance has forced many small credit unions to seek out merger partners. Regulatory compliance requires adequate staffing, higher administrative costs and computer capabilities that may exceed the limited resources of smaller credit unions. (iii) Keeping up with changes in technology requires large amounts of capital and personnel resources, credit unions need the size mergers create to become major players in today's technology-driven business. (iv) For employer-based credit unions, the failure or downsizing of a key employer may necessitate merger activity. (v) Many mergers occur because of the desire to provide more services to members. Mergers usually develop because small credit unions want to give members opportunities for credit card accounts, ATM services, mortgage services and other products that larger institutions offer. (vi) Some mergers set out to accomplish a strategic business objective. For example, some credit unions look at mergers as an efficient way to grow and improve the credit union's position in a fiercely competitive marketplace. Byrne, McCarthy and Ward (2012) argue that one of the gaps in the credit union literature is a discussion on the impact of mergers on the long term relationship of the

credit union with members. The authors found that credit union members in Ireland value their relationship with their credit union and are not willing to trade the local nature of the credit union for increased services.

^x For further information see Rabobank Economic Research Department “*The European banking sector and the co-operative banks*” (2009).

^{xi} PRISM (Probability Risk and Impact System) is new risk based supervision framework for the Central Bank which establishes a new approach for supervisory engagement with regulated firms. For further information see <http://www.centralbank.ie/press-area/press-releases/Documents/1%20December%202011%20PRISM%20Explained%20-%20Booklet.pdf>

^{xii} Jones (2010) argues that “stabilisation programmes are built on a number of common principles. These include regulatory compliance, meeting robust performance standards as a condition of entry and of ongoing participation; regular off-site and on-site monitoring, examination and supervision; financial and technical assistance for unstable credit unions targeted at securing recovery; the authority and mechanisms for the responsible authority to intervene; and procedures to instigate credit union mergers or liquidation if required. In addition, all known examples of stabilisation programmes regard stabilisation as a component part of deposit insurance.”

^{xiii} The Commission notes that there are elements to this framework other than those listed here.

^{xiv} After Canadian credit unions first adopted deposit insurance in 1970, only credit unions in the US subsequently emulated them with the establishment of the National Credit Union Share Insurance Fund (NCUSIF) in 1971. Post 1995, however, deposit insurance for credit unions has grown rapidly. Much of this growth was concentrated in Europe. There, for example, Irish credit unions voluntarily established their in-house Savings Protection Scheme (SPS) in 1989. In Poland, the Czech Republic and Lithuania, credit unions have been legally required to adopt deposit insurance since 1996, 2000, and 2001 respectively. British credit unions joined the Financial Services Compensation Scheme (FSCS) in July 2002 and Latvian credit unions were included within their state deposit guarantee system in January of 2003. More recently the financial crisis has seen almost blanket coverage of financial institutions, irrespective of their form, with deposit insurance. By 2009, almost 100 countries had introduced a deposit guarantee scheme (Alessandri and Haldane, 2009).

^{xv} Under the Financial Services (Deposit Guarantee Scheme) Act 2009, the Minister for Finance has discretion as to the rate specified for a particular class of financial institution.

^{xvi} The Commission notes that the issue of credit union viability should be viewed not as a discrete point but as a spectrum of differing degrees.

^{xvii} In the US the National Credit Union Administration (NCUA) was formed to charter and supervise federal credit unions. In assessing credit union viability two areas of particular concern to the NCUA are loan delinquency and capital adequacy with credit unions classified in terms of their capitalisation. Five categories of capitalization, in terms of the ratio of net worth-to-assets are used: ‘well capitalized’ greater than 7%; ‘adequately capitalized’ between 6% and 6.99%; ‘undercapitalized’ between 4% and 5.99%; ‘significantly undercapitalized’ between 2% and 3.99%; and ‘critically undercapitalized’ less than 2%. Credit unions classified as ‘well capitalized’ are free from supervisory intervention under the Prompt Corrective Action (PCA) system. Credit unions classified as ‘undercapitalized’ or below are required to take progressively more radical steps to restore net worth to adequate levels. If a credit union’s capital falls below 2% it is deemed to be ‘not viable’ and must be either taken over by the NCUA (Conservatorship), merged or liquidated.

In recognition of the time it takes for a new credit union to accumulate net worth, a less stringent system is applicable to credit unions less than 10 years old, and with assets of less than \$10 million: ‘well capitalized’ greater than 7%; ‘adequately capitalized’ between 6% and 6.99%; ‘moderately capitalized’ between 3.5% and 5.99%; ‘marginally capitalized’ between 2% and 3.49%; ‘minimally capitalized’ between 0% and 1.99%; and ‘undercapitalized’ less than 0%.

^{xviii} US Government Accountability Office (GAO) (2011) analysed the effectiveness during the financial crisis of PCA capital triggers for US banks. It concluded that while the PCA framework provides benefits, such as facilitating orderly closures and encouraging banks to increase capital levels the effectiveness of PCA is limited because of its sole reliance on capital, which can lag behind other indicators of bank health. That is, problems with the bank’s assets, earnings, or management typically manifest before these problems affect bank capital. Once a bank falls below PCA’s capital standards, a bank may not be able to recover regardless

of the regulatory action imposed. GAO tested other financial indicators, including measures of asset quality and liquidity, and found that they were important predictors of future bank failure.

^{xix} Academic research on credit union failure is limited. Part of the reason for this is that in many countries only a small number of credit unions fail. Rather than permit a credit union to fail there is a tendency for the poorly performing credit union to transfer its engagements to another credit union. This tendency can be viewed almost as an extension of co-operative principles. Research that is available indicates that both microeconomic and macroeconomic factors are important. Wilcox (2005) in an analysis of US credit unions argues that just two macroeconomic factors, the unemployment rate and the prior year's real interest rate, may account for over half of the variation of National Credit Union Share Insurance Fund, (NCUSIF) loss rates from 1971-2004. Referring to microeconomic factors Gordon (1987) suggests that small less well capitalised credit unions are more likely to fail. Other important determinants of failure include: a lack of trained managers; weak lending and collection operations; poor record keeping; and closures of sponsoring companies. Smith and Woodbury (2010) in a comparative study of banks and credit unions suggest that credit unions are far less exposed to fluctuations in the business cycle and as such are much more able to withstand macroeconomic shocks to their balance sheets. For more details on these studies see McKillop and Wilson (2011).

^{xx} The recommendations by the Commission relating to the Credit Institutions (Resolution) (No.2) Bill 2011 are based on the Bill as published on 24 May 2011.

^{xxi} 9.— (1) The intervention conditions are fulfilled in relation to an authorised credit institution if—
 (a) either condition A or condition B is fulfilled,
 (b) conditions C and D are both fulfilled, and
 (c) the Bank has consulted the Minister.
 (2) Condition A is that the Bank has serious concerns relating to the financial stability of the authorised credit institution concerned and—
 (a) directs that credit institution to take particular action to address the Bank's concerns, and the Bank is satisfied that—
 (i) the credit institution has failed to comply fully with the direction under this paragraph, or
 (ii) the credit institution is incapable of taking the necessary action to so comply within the period specified by the Bank in that direction,
 or
 (b) is satisfied that, having regard to the urgency of the situation or for any other reason, its serious concerns cannot be adequately addressed by such a direction.
 (3) Condition B is that the Bank is satisfied that there is a present or imminent serious threat to the financial stability of the authorised credit institution concerned or the financial system in the State.
 (4) Condition C is that the Bank is satisfied that the authorised credit institution concerned has failed or is likely to fail to meet a regulatory requirement imposed by law or a requirement or condition of its licence or authorisation.
 (5) Condition D is that having regard to the purposes of this Act, any guidelines issued by the Bank under section 107 and such of the matters set out in subsection (6) as appear to the Bank to be relevant in the circumstances, the immediate winding-up of the authorised credit institution concerned is not in the public interest.
 (6) The matters referred to in subsection (5) are the following:
 (a) whether the authorised credit institution concerned is of systemic importance to the economy of the State;
 (b) whether the failure of that credit institution would be likely to contribute to instability of the banking system or serious damage to the financial system in, or the economy of, the State;
 (c) the importance of ensuring that the depositors of that credit institution will continue to have prompt access to their deposits (whether in that credit institution or elsewhere);
 (d) the importance of maintaining public confidence in the financial system in the State;
 (e) the importance of maintaining continuity of banking services to that credit institution's customers;
 (f) the terms of any resolution plan for that credit institution;
 (g) any other matters that the Bank considers relevant, in the particular circumstances, having regard to its duties and obligations.

^{xxii} In the US the NCUSIF was initially capitalised with the residual funds of the trade association deposit insurance programmes. This amounted to around 0.3% of the totally insured deposits. The NCUSIF was re-capitalised in 1985 by each credit union depositing an additional 1% of its insured share deposits into the fund. This has resulted in a fund of around 1.3% of credit union member savings. Credit unions must maintain a 1%

deposit of their members' savings with the NCUSIF, adding to the deposit as savings increase. This is recorded as an investment in the NCUSIF.

^{xxiii} Partly due to the restrictions on their activities, US credit unions have, in general, withstood the current financial crisis better than many of their banking counterparts (Klinedinst, 2010). This can be gauged through examination of coverage ratios (total equity divided by insured shares or deposits). Coverage ratios were 1.29% and 1.22% in 2007 for the NCUSIF and FDIC respectively; 1.26% and 0.36% in 2008; 1.30% and -0.39% in 2009; and 0.24% and -0.28% in 2010. The sharp fall for the NCUSIF in 2010 was due primarily to heavy losses at some corporate credit unions, requiring the creation of a Corporate Stabilization Fund. Hampel (2010) estimates the cost to the NCUSIF in 2010 of corporate stabilization was around \$8.1 billion and that without this adjustment the coverage ratio for 2010 would have been 1.30%.

^{xxiv} Jones (2010) notes that in the US credit unions receiving stabilisation assistance in order to continue operating independently "must justify receiving the special assistance, and demonstrate that the assistance will help make the credit union a financially viable financial institution". NCUA assistance can be either temporary or permanent. Temporary assistance is normally limited to six months and permanent to a 24-month workout period. Normally, permanent assistance is not given easily but is dependent on nine preliminary requirements being met. Before any attempt to stabilise a credit union there is a rigorous assessment of its chances of long-term viability. The nine requirements are:

1. A viable field of membership
2. Capable management
3. Accurate and current books
4. Full and fair financial disclosure
5. Proper written policies and procedures (or realistic plan to put them in place)
6. Approved net worth restoration plan or risk based plan (including the impact of repayment of assistance)
7. Positive track history of financial performance and resolving problems
8. Correction of root problems
9. System for monitoring on-going performance.

^{xxv} The CAMEL (later to become CAMELS) system was implemented in the US in 1980 in order to reflect an institution's financial condition, its compliance with laws and regulatory policies, and the quality of its management and systems of internal control. Each institution is subject to yearly on-site examination, with the examiner judging the institution on six dimensions, referred to as component factors. These are:

Capital adequacy;
Asset quality;
Management;
Earnings;
Liquidity; (Asset/Liability Management used instead by NCUA.); and
Sensitivity to market risk.

Benchmarks for each component are provided as guidelines, but the on-site examiner has discretion to consider other pertinent factors. Each dimension is rated on a scale from 1 (best) to 5 (worst). These are combined to give a composite CAMEL(S) rating which is taken as the prime indicator of a financial institution's current financial condition. While the use of benchmarks and a uniform rating system allows a reasonable degree of confidence when comparing and evaluating institutions, this system remains inherently subjective, as a consequence of the discretion afforded to the on-site examiner. An advantage of CAMELS is that it also incorporates a forward looking approach rather than giving snapshot of the credit union at a particular time.

^{xxvi} Ralston (2001) argues that regulation imposes a number of restrictions on the portfolios of financial institutions including controls on capital, liquidity and asset composition. These controls are aimed at containing the rate of institutional failure and inspiring confidence in a stable financial system. At the same time, however, these restrictions should not impede the efficiency of financial institutions as the ideal regulatory system requires a balance between preventing market failure and allowing financial markets to perform efficiently.

^{xxvii} Pana and Mukherjee (2010) examine the level and determinants of liquidity created by US credit unions. The authors show that the level of liquidity increased by 50% over the 2000 to 2008 period, reaching a level of \$318 billion in 2008 and that the contribution of large credit unions to aggregate liquidity has increased

over time, while the role played by medium and small credit unions has diminished. The authors also consider the role of capital in influencing liquidity creation. The results suggest that higher levels of capital reduce the ability of US credit unions to create liquidity. Furthermore, capital levels exceeding minimum regulatory requirements undermine credit unions' incentives to monitor borrowers and extend loans. Consequently, the choice of increasing the relative weight of liquid assets at the expense of investments in loans results in a lower level of liquidity created.

^{xxviii} Rauterkus and Ramamonjiravelo (2010) examine the impact of US credit union risk characteristics and macroeconomic events on deposits. Looking at a sample of US credit unions from 2004-2008 they find that credit union depositors do not consistently punish credit unions by deposit withdrawal for risky behaviour. Furthermore, they find that credit union deposits increase in times of economic uncertainty and suggest that this indicates that there is a group of people that consider credit unions a safe haven during an economic crisis. The authors state that this sheds a whole new light on the importance of credit unions.

^{xxix} Corporate governance in publically trade companies has been widely studied. These studies have focused attention on issues such as excessive executive power, shareholders' inability to oversee and control management, the weak regulatory regimes of national governments, and corporate social responsibility (Spear, 2004). While less attention has been paid to corporate governance in the non-profit co-operatives and credit unions sectors, the paucity of study in this area should not be taken as a measure of the importance of examining governance in these sectors. The co-operative and credit unions sectors have a very different ethos to publically trade companies but they face similar challenges in the area of governance, in particular, the need to ensure director and board competency and effective member control over management. That said, governance approaches developed with the corporate sector in mind may be inappropriate for the co-operative context. While Axworthy (1990) acknowledges that there are questions about whether or not the research on private corporation directors can be applied in a co-operative context, he notes that the duties are essentially the same. Axworthy goes on to identify four fundamental differences between co-operatives and corporations and these may impact on governance and how directors perceive their role: co-operatives are member-owned, they do not exist solely for the purpose of making profit, they are democratically controlled and their directors are elected and not necessarily versed in business.

^{xxx} Ketilson and Brown (2011) argue that the co-operative sector faces significant governance challenges emphasising that "for co-ops, governance concerns extend beyond the need for ethical accounting practices and sound board structure; co-op governance must also address issues of member engagement and democracy." In an Irish context O'Sullivan (2012) discusses the responsibilities of the board of directors and how board performance might be measured. He argues that PEARLS ratios may be useful to inform assessment of the management decisions of the board of directors. He further argues that Supervisory Committees need to put greater emphasis on the education and training performance of their respective boards of directors, perhaps even including it in their assessment report. Goth, McKillop and Wilson (2012) in an analysis of Canadian and US credit unions suggest an enhanced role for a governance committee in overseeing board performance in aggregate as well as in separately assessing the performance of directors on an individual basis.

^{xxxi} As the credit union grows and engages in more complex and sophisticated operations, so too does the need for higher qualified staff. From the perspective of corporate governance, the growth of credit unions has meant that the board of director's control over the credit union has diminished as the operation of credit unions becomes the responsibility of professional management and staff (Sibbald et al., 2002). Furthermore, boards of directors of co-operatives are less likely than the boards of publicly traded corporations to monitor or replace management (Rasmusen, 1988; Fama and Jensen, 1983). A further impact of the professionalisation of the day-to-day operations of credit unions is paid staff seeing volunteers as 'enthusiastic amateurs' committed to the traditions of the movement and a diminishing of the highly personal nature of service (Sibbald et al., 2002; Black and Duggar, 1981; D'Amours, 1998; Swoboda, 2002; Likens, 2002). The challenge in the relationship between owners and managers (the principal-agent problem) is how the owners can ensure that managers will make decisions aligned with the owners' best interests. There is a danger that managers will make decisions in their own personal interest rather than in line with the mission of the organisation and that they will make choices based on securing their own positions in the organisational structure (Williamson, 1963, 1964; Labie and Perilleux, 2008; Leggett and Strand, 2002). Branch and Baker (2000) suggest that these problems can arise in credit unions when there is: a lack of clear rules separating decision oversight from decision making, an unqualified person in a position of decision oversight, inadequate management competitiveness, a failure of the membership and board to exercise fiduciary responsibilities and the one-person one vote system.

^{xxxii} Section 60 (1) (b) of the Credit Union Act 1997 (unofficial consolidated version).

^{xxxiii} Section 60 (1) (c) of the Credit Union Act 1997 (unofficial consolidated version).

^{xxxiv} Board development refers to building a board of directors that is capable of carrying out its roles and responsibilities in an effective and efficient manner, three key components to board development: recruitment, education, and evaluation. The continuing training and education of directors is relevant for all directors, regardless of their skills, expertise, or experience and is critical for the success of credit union boards. One of the first educational experiences that new directors should have is an orientation exercise that introduces them to the credit unions affairs and other board members. Hoyt (2003) argues that director orientation is an effective and efficient way for new board members to learn key board practices, processes, and policies. Furthermore, Hoyt suggests that boards should demonstrate their commitment to director training and education by allocating the financial and time resources that allows directors to take advantage of such opportunities. She also argues that training and education activities should aim to develop individual and group capacity in strategic areas.