ReBo

The Credit Union Restructuring Board

An Bord Athchóiriú Comhar Creidmheasa

Credit Union Restructuring Board

Submission to

Department of Finance
Consultation Paper on the Stabilisation Levy

19th May 2014

Introduction:

The Report of the Commission on Credit Unions (‘**CCU’**) recommended the establishment of a ‘steady-state stabilisation mechanism’ for individual credit unions and the sector as a whole to apply under certain conditions to credit unions that are facing difficulties maintaining minimum reserve requirements but are otherwise considered viable by the Central Bank.

Stabilisation support is given legislative authority under Part 4 of the Credit Union and Co-Operation with Overseas Regulators Act 2012 (‘**the Act**’) and will be funded from the Credit Union Fund. Section 59 of the Act requires the Minister to make regulations prescribing the rate of and method of calculation for a levy contributing to the Credit Union Fund.

The Department of Finance has issued a consultation paper setting down its initial thoughts and seeking the views of sector stakeholders before making a final recommendation to the Minister in relation to a stabilisation levy. That consultation paper forms the basis of this response.

Situational Analysis:

Section 3 of the Credit Union Act 1997 (Section 85) Rules 2009 (S.I. 344 of 2009) requires a credit union to continually maintain a minimum Regulatory Reserve Ratio of at least 10%. It is calculated at a flat rate across total assets and so lacks the ability to reflect the risk profile of those assets.

There are currently 389 credit unions in Ireland and they are generally well capitalised. Based on the December 2013 prudential returns available to ReBo, there are very few credit unions to whom stabilisation would apply under the reserve assumption (i.e. greater than 7.5% but less than 10%). The combined assets of those credit unions represent a small fraction of the sector, the funding requirement would be negligible and in some cases they should be capable of returning to full capitalisation through the appropriation of their own surpluses in the short term.

The greatest risk and uncertainty lies with credit unions that currently exceed the minimum reserve requirement but may face impairment charges on their assets.

Consultation Questions:

1. ***Does a fund of €30m represent a reasonable estimate of the size needed for the fund?***
   Based on an analysis of the funding requirements for credit unions currently falling between the reserve limits applicable to stabilisation support, ReBo estimates that a fund of €30m would exceed requirements, with a figure around one fifth of that being required for present purposes based on the most recent prudential return data. While it is difficult to estimate a future funding requirement with reasonable levels of certainty, the

size agreed should be justified by the financial data available and be cognisant of historic trends in capital shortfalls, the events likely to give rise to the fund being drawn from and the extent to which the risks of drawdown are mitigated.

2. ***Is the proposal to build a target fund of €30m over a 6 year period consistent with maintaining the financial viability and sustaining the commercial position of credit unions?***

   A future fund of a size appropriate for the sector considering the risk profile of the assets held should be reactive to the economic cycle and accumulated accordingly, being built up in times of economic expansion and rapidly released in times of economic contraction. This would allow a fund to be built up when it would have the least impact on the commercial position of credit unions and released when required to counteract the worst effects of a 'credit crunch'. The countercyclical capital buffer proposed in Basel III demonstrates how similar, cycle linked prudential initiatives operate in other jurisdictions. As per question 1 above, there would need to be grounds established for a fund of €30m that relies on financial data.

3. ***Should the levy be fixed rate or based on the asset size of credit unions?***

   Smaller credit unions have been affected more severely, proportionate to their ability to pay, by increased regulatory costs and it would be unreasonable to expect them to contribute at the same level as the largest credit unions. It would appear to be more equitable for contributions to be calculated on the basis of asset size.

4. ***Should the levy be adjusted to take account of nature, scale, complexity and risk?***

   As noted in the consultation paper, it is difficult to find a credible measure of risk which is specific to a stabilisation context. The more obvious solution would be the risk weighting of assets in reserve calculation. A levy based on asset size would generally take account of a credit unions nature, scale and complexity.

5. ***Should the levy take account of the extent to which a credit union has benefitted or may benefit from stabilisation support?***

   A credit union that benefits from stabilisation support will be required to repay the fund in full as well as facing other possible conditions such as changes to governance and business operations. Those conditions are sufficiently unattractive to deter credit unions from relying on stabilisation support without the need to penalise an entity already in financial difficulty. In the vast majority of cases, an exceptional cost rather than recurring losses will cause a viable credit union to deplete its capital position and so it would be impossible to identify a future need for funding support in advance of an unforeseen event.

6. ***Are there any other suggestions on a proposed approach together with supporting rational?***
   - In order for a stabilisation support scheme to be fit for purpose there must be confidence that the underlying regulatory reserve calculation method is appropriate. Risk weighting assets as part of the calculation should form part of the proposal. It is a fundamental component in any sophisticated regulatory regime, represents international best-practice and encourages prudence. Moreover, specific reference to the risk profile of a credit union is made in both the CCU and the Act. The Central Bank has also previously advocated for a risk based approach to be introduced in its publication; "Regulatory Reserve Ratio for Credit Unions" (August 2009).
   - The views of the ReBo Board, expressed by the Chairman in a letter to the Minister on 11th December 2012 (copy attached) remain largely unchanged. Multiple levies feeding into sub-funds will cause a great deal of confusion during the lifetime of ReBo and a single levy should be applied. It is also still believed that a stabilisation process operating in tandem with the restructuring phase will cause further confusion. However, with access to the prudential data, ReBo is satisfied that the cost of stabilisation would be significantly less than the proposed fund and could possibly be borne by the sector.
   - Stabilisation support will only be available to viable credit unions within a very restrictive range of reserve positions. It is imperative that a suitably robust definition of 'viable' be provided before a final determination is made on the stabilisation levy. The CCU recommended that the CAMELS system play a role in defining viability, however there is no reference of this in the proposal.
   - The accounting basis on which funding will be provided to a credit union will need to be clarified if it is to be both recoupable and apportioned to reserves. The ability of recoupable funding to enter the balance sheet and be apportioned to

reserves may require a legislative basis. It is also not immediately apparent where the requirement for the funding to be recoupable is derived from.

- It will be important to address the issues in the valuation of assets in some credit unions. For example, having adjusted the reserve positions of all credit unions based on the latest prudential data, reducing the fixed assets to total assets ratio to 5%, there is an increase in the number of credit unions to whom stabilisation would apply. The capital shortfall remains negligible and the funding requirement would be minimal compared to the fund proposed. ReBo estimates a fund of €6m would be sufficient for present purposes.