The Opportunity for Irish Credit Unions in SME Lending

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July 2021

CFCFE Centre for Community Finance Europe

CUBS Cork University Business School

FSIC Financial Services Innovation Centre

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CFCFE is rooted in values of co-operation, participation, social and financial inclusion, transparency, integrity, and excellence. Much of its work is done in collaboration with Liverpool John Moores University.

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Executive Summary

In a world still recovering from the financial crisis of the last decade and the health crisis of the last 18 months, credit unions face two challenges in building their SME loan business. Credit union appetite for risk is low, and loan demand from SMEs declined during the economic slowdown.[1] But today, with business activity on the upswing, there has rarely been a moment in recent memory when the opportunities for SME lending have grown as rapidly and the economic necessity of supporting SMEs in rebuilding their cash flow has been so critical. SMEs play a key role in the Irish economy and communities, representing two thirds of the country's total employment.[2]

This research focuses on the twin challenges of SME lending by credit unions, exploring what levers might build confidence in lending to SMEs, such that loan books begin to grow again. It looks at examples from other countries and situates the role of collaboration and technology in supporting the design of new services.

Lending to SMEs by credit unions in Ireland is operating below the capacity allowed for in revised lending maturity limits defined by the Central Bank of Ireland in 2016. The reasons for this reluctance are a lack of underwriting expertise, the low risk appetite of credit union Boards and CEOs, a cultural perception that micro-enterprise lending should be limited to what are in effect personal loans, and a mismatch between credit union business models and evolving member requirements.

We find that collaboration is key to accessing the resources required by credit unions in both underwriting resources and the technical infrastructure to reach the target audience of SME owners. Lessons are learned by looking at how Financial Technology (FinTech) companies use data to target customer segments with appropriate loan rates.

This research challenges credit unions to leverage close member relationships to help fund growth for micro and small enterprises, minimising the risk by sharing the investment in required infrastructure, and opening management culture up to one of data-driven decisioning support.

[1] Sibley E. (2020) Braving the storm: the unprecedented challenges facing SMEs, speech to Small Firms Association, Central Bank of Ireland, 4 November 2020

[2] Central Statistics Office (2015), Business in Ireland, CSO statistical publication, 17 November 2017

1. Introduction

This research paper investigates the potential opportunity for credit unions in SME lending and the reasons for the lack of engagement by credit unions in SME lending to date. Research findings are based on interviews with CEOs of credit unions, along with stakeholders from Irish government and other retail banking institutions.

One of the challenges of analysing SME lending requirements is the diversity of the businesses themselves, which can range from small operations run by an individual to larger organisations with hundreds of employees. There are also critical differences between lending to SMEs with established business track records and those that are brand new start-ups. Correspondingly, the requirement for credit varies greatly from cash flow to capital investment for business development.

Credit unions are by definition local, have an in-depth knowledge of their members' credit history and prospects, and are not tied into the same profitability models of their counterparts in the retail banking sector. They are ideally placed to collaborate with SMEs in their requirements for credit, but their member owned co-operative ethos tends towards risk aversion.

This paper is structured as follows. Firstly, we detail the features of the credit union sector in Ireland, including the credit union business model, risk appetite, technology implementation, collaboration, and innovative forms of SME lending. We later present our findings, along with a discussion of what credit union CEOs perceive as the barriers to the expansion in lending to SMEs and what can be done to facilitate it. We conclude by providing suggestions to strengthen the SME lending capability of credit unions.

2. SME lending definition and legal constraints

2.1. European definition

Under the current EU definition for SMEs, enterprise size in terms of headcount and financial scale (assets or turnover) is the main criteria used, but access to additional resources (through partnership, for example) is also used to identify an enterprise as an SME. According to size, three classes of SMEs are distinguished: [3]

[3] Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, EU Official Journal L 124, 20/05/2003 P. 0036 - 0041

Enterprise category	Staff Headcount	Financial ceilings		
		Turnover	or	Balance sheet total
SMEs	< 250	≤ € 50 million		≤ € 43 million
Small	< 50	≤ € 10 million		≤ € 10 million
Micro	< 10	≤ € 2 million		≤ € 2 million

Table 1 EU SME classification by headcount and financial ceilings

The EU classification system has been incorporated into the legal definitions of business lending for Irish credit unions, as covered in the next section.

2.2. Definition of business lending under Irish credit union law

For purposes of the lending covered by this paper, the Central Bank of Ireland has defined "business loan" to be a loan that is made to:

> "a member, or where there is more than one member, at least one of those members, that satisfies the following conditions:
>
> (i) the loan is made for purposes of the person's trade, business or profession;
>
> (ii) the person is a micro, small or medium-sized enterprise within the meaning of Commission Recommendation 2003/361/EC;
>
> (iii) the loan is not made for the purpose of financing, in whole or in part, the purchase, construction or refinancing of buildings or the purchase or refinancing of land that the person intends to rent to a third party in order to generate income;[4]

The spirit of the law here is to ensure that business loans are assessed as such in terms of risk. Hence, it is not surprising that credit unions frequently mis-categorise loans to micro enterprises as being personal loans.[5] While micro enterprises can have as many as 10 workers, they can be sole proprietorships with no workers other than the owner and perhaps one or two more. In reality, loans to such businesses take on the risk characteristics of personal loans to the business owners. This will be discussed further in Section 5.1.5.

2.3. Concentration limits under Irish credit union law

Regulations issued by the Central Bank in 2019 removed the previous per cent-of-total-loans concentration limits for house and business loans and replaced them with

[4] Credit Union Act 1997 (Regulatory Requirements) (Amendment) Regulations 2019

[5] Interviews with credit union officials and stakeholders.

limits, on a tiered basis, expressed as a percentage of total assets. This provides Irish credit unions (especially larger credit unions) with the flexibility to undertake increased longer-term house and business lending as a combined percentage of their total assets: [6]

7.5% of assets combined limit	Available to all credit unions	Maximum of 5% of total assets may be in business loans
10% of assets combined limit	Credit unions with assets >€50 million	Maximum of 5% of total assets may be in business loans
15% of assets combined limit	Credit unions with assets >€100 million	Entire 15% limit may be in house or business loans, subject to any condi-tions required by Central Bank approval

3. Credit union SME lending market in Ireland

Small to medium sized businesses are a critical pillar of the Irish economy, with approximately 250,000 active SMEs in Ireland in 2016.[7] However, in June 2019 the Central Bank reported that of the €5 billion outstanding in credit union loans, €4.6 billion related to personal lending and only €112 million was for commercial lending.[8]

	Personal Loans	House Loans	Commercial Loans	Community Loans	Other Loans	Total
Sep-16	3,913.4	112.6	62.1	13.7	44.2	**4,146.1**
Dec-16	3,952.8	127.3	62.1	17.4	7.0	**4,166.6**
Mar-17	4,017.5	138.1	67.0	18.0	4.7	**4,245.2**
Jun-17	4,107.7	154.5	74.1	12.8	3.9	**4,353.0**
Sep-17	4,191.0	146.3	77.8	14.5	25.5	**4,455.1**
Dec-17	4,224.3	153.4	79.2	13.6	7.1	**4,477.5**
Mar-18	4,280.8	160.2	84.4	14.2	2.5	**4,542.0**
Jun-18	4,373.6	164.8	91.1	14.5	29.9	**4,673.9**
Sep-18	4,507.0	171.2	92.5	15.0	3.3	**4,789.1**
Dec-18	4,514.8	173.1	99.0	15.1	4.1	**4,806.1**
Mar-19	4,572.7	176.3	106.2	15.1	4.3	**4,874.6**
Jun-19	4,673.9	182.2	112.7	14.1	5.3	**4,988.1**
Source: Central Bank of Ireland						

6 Credit Union Act 1997 (Regulatory Requirements) (Amendment) Regulations 2019

7 Irish League of Credit Unions (2020), Credit Unions: A Vehicle for SME Funding in a Rebooting Post Covid-19 Economy, p16

8 Indecon (2019), Evaluation of Concept of Community Banking in Ireland, report submitted to Dept of Finance, December, pp.25

More recent data has been furnished to the authors by CUFA Ltd.[9], which provides credit risk analytics software to credit unions who represent about 55% of Irish credit union loans. As of 31 March 2021, 46 out of the 59 credit unions reporting data to CUFA had commercial loans outstanding. Their €49 million in business loans represented only 2.2% of their total loans of €2.7 billion.

59 Irish CUs Using CUFA Lending Analytics As of 31 March 2021 - Euro		
Original Term of Business Loan	Loans in Category	Ave. Original Amount
1 Year	36	12,647
2 Years	57	3,977
3 Years	151	4,629
4 Years	160	7,406
5 Years	864	11,094
6 Years	132	11,627
7 Years	577	17,006
8 Years	50	16,207
9 Years	24	32,331
10 Years	154	39,563
11-14 Years	38	8,631
15+ Years	84	40,290

CUFA offers its software with the assurance that it will provide users with a deeper understanding of how their business and other loan products are performing, at either a group or individual level. Examples from CUFA's software are shown in Section 8.

The relatively limited scale of SME lending is not unique to credit unions. A persistent finding in the Department of Finance SME Demand surveys has been a decline in the demand for commercial bank lending by Irish SMEs. This has fallen from 40% in the initial survey in the depths of the downturn in early 2013 to the current level of 20% in the most recent survey in September 2018.

Nevertheless, our research also suggested that there is an opportunity for credit unions to target micro-enterprises due to a lack of engagement by larger retail banks in this space.

> *"Retail banks engage in SME lending but are not focused on micro-SME lending because of high legacy cost base (it is simply not worth their while doing it). MicroSME cost is too high for banks. There is an opportunity for credit unions to take advantage of this gap in the market."*
>
> *Credit Union Policy - Department of Finance Ireland*

While the reluctance to engage in commercial lending is frequently linked to economic trends outside the control of credit unions, it is useful to look at best practice in more active markets for SME loans. The next section looks at the situation in the US and Canada, where business lending makes up a substantial share of credit union loans.

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[9] CUFA Ltd, http://cufa.ie

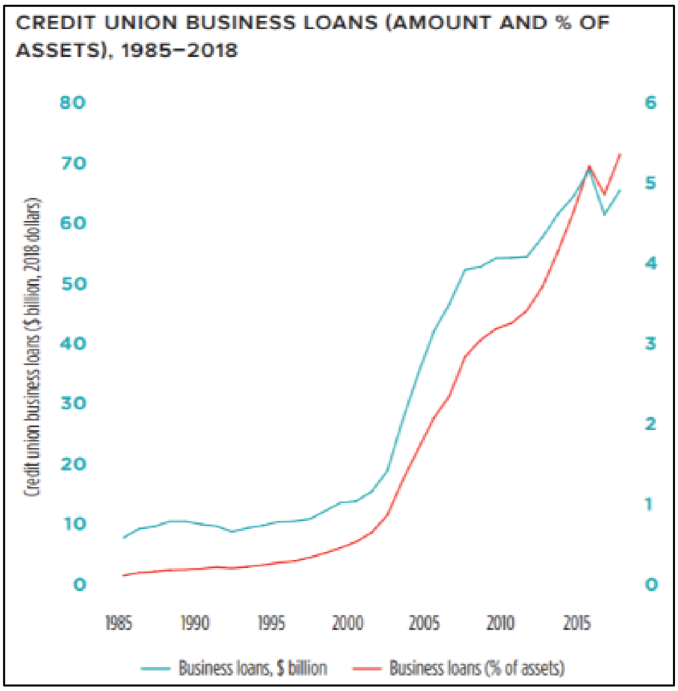
4. Business lending in the USA and Canada

USA credit unions that offer commercial loans are required to maintain prudent risk management practices and adequate capital suitable to the risks associated with that activity. Their most common commercial loan products are term loans, lines of credit, and letters of credit.

In the USA, the percentage of credit unions offering business loans is constantly growing. In 2018, 34.5% of all credit unions offered business loans, as shown in the chart below. The literature indicates that most credit unions offer a full range of financial products and services (either directly or through third parties), and therefore US consumers consider even small credit unions as being full-service alternatives to the banks.[10]

The Federal Credit Union Act generally limits federal credit unions to a 15% interest rate ceiling on loans. However, the Federal regulator may permit a higher rate for up to 18 months after considering certain statutory criteria.[11]

In Canada, credit union commercial loans must be reflective of the size and complexity of the credit union, its lending capabilities, risk appetite, and underwriting skills. Typical credit union business loan products include term loans, operating lines of credit, construction mortgages, loans for real estate and rental properties, letters of credit, syndicated loans, and leases.[12] Canadian credit unions are one of the leaders globally in small business lending because of a strong regulatory framework



[10] Jones P.A., Money N., Swoboda R. (2017), The Irish Credit Union Business Model: Is it still fit for purpose? Centre for Community Finance Europe, Dublin, December 2017

[11] National Credit Union Association, Permissible Loan Interest Rate Ceiling Extended, letter to all credit unions, June 2015

[12] DICO (2014), Commercial Lending Policy Development Guide: Minimum expectations, Class 2 Institutions, Deposit Insurance Corporation of Ontario, February, p.4

that provides flexible capital and liquidity. For the country as a whole, they have a business lending market share of 18.5%.[13]

Canadian credit union law provides flexibility in setting interest rates,[14] so larger credit unions can design attractive products for SMEs seeking to get started, or those who may not (or no longer) have access to lines of credit.[15]

5. Reasons for a lack of engagement in SME lending

Our research findings indicate that legal limits on the size of SME lending are not a major contributor to the low levels of credit union SME lending across Ireland. Instead, the major contributing factors are:

- Lack of underwriting expertise
- Lack of capacity
- Risk appetite of Boards and CEOs
- Inconsistent categorisation of loans
- Business models are limited primarily to instalment loans, forcing members to the for-profit financial sector for many of their credit needs.

4.2. Lack of underwriting expertise

A lack of expertise in the underwriting of commercial loans is a major factor for credit unions not engaging in SME lending.

> *"To do SME lending, there is a requirement to have specialised capabilities for underwriting. Assessment is completely different so you must acquire people from banks with experience in this field. Why is the assessment different? Credit union personal lending is built off a historic relationship, but commercial lending is different."*
>
> *COO, large Irish credit union[16]*

It also results from a lack of understanding of how SME creditworthiness is impacted by cash flows:

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[13] Canadian Credit Union Association (CCUA), (2018), Credit Union Community and Impact Report, p7

[14] Credit Unions and Caisses Populaires Act, 1994, Ontario Regulation 238/09O. Reg. 238/09: Cost of Borrowing and Disclosure to Borrowers

[15] VanCity offers 5-7 year term loans for micro-enterprises at ~5.45% (prime + 3%) interest rates https://www.vancity.com/BusinessBanking/Financing/Loans/SmallBusinessAndStartup/

[16] Over €100m in assets

> *"Reasons credit unions will fail at commercial lending is the cash flow issue. They do not understand the cash flow requirements of SMEs.*
>
> *Chair, small UK credit union*[17]

5.1. Capacity (asset size)

Capacity was another factor that inhibited some credit union's ability to undertake SME lending. Several credit unions noted that due to their size and scale, it simply is not worth the time, resources, risk and cost to engage in commercial lending.

> *"We simply do not have the expertise nor capacity and SME loans are generally high cost, high risk and low return."*
>
> *CEO, large Irish credit union*

Another credit union CEO who does engage in SME lending argued that:

> *"People running credit unions often lack experience in commercial lending and this is why they do not get involved with SME lending. Therefore, I hired an experienced workforce to help with SME lending (25 years' experience or more in SME lending). I believe smaller credit unions need to collaborate and pool resources."*
>
> *CEO, large Irish credit union*

5.2. Organisational Culture

As discussed in Section 2.3, the expertise of credit unions is a critical factor in their risk appetite for SME lending. While larger credit unions have now developed more sophisticated systems to identify, monitor and report on risks, they encounter challenges in translating these resources into an effective risk culture for lending. From the top down, credit unions are 'in safe hands' as they are governed, professionally managed, and staffed by competent, capable individuals who prudently manage risks, while successfully meeting members' product and service expectations.

> *"Credit union CEOs are good at managing the business, but this comes at the price of sacrificing outside of the box thinking."*
>
> *Stakeholder interview*

This risk averse culture has greatly affected many CUs willingness to engage in SME lending.

[17] Less than €10 million in assets

"It is not regulatory limits, capacity or asset size that restrict credit unions from engaging in SME lending. Instead, it is the culture and mindset of people within credit unions who make the decisions."

Stakeholder interview

Policy interventions have had limited success in boosting credit union confidence in SME lending.

This reticence was in evidence prior to the Central Bank legal limit requirements on commercial lending being adopted in 2016. Credit union managers are challenged with other more fundamental changes to their business models, which further discourages them from taking risks on the loan book.

In the context of economic uncertainty (2008 financial crisis, 2020/21 health crisis) it is unsurprising that both credit unions and their members are risk averse.

5.3. Appetite for diversification

Each credit union interviewed was asked about their risk appetite towards commercial loans. Results indicate that the majority of credit unions with a lower risk tolerance were smaller credit unions with a smaller asset size. Larger credit unions had a greater risk appetite and engaged in SME lending to a higher degree. The CEOs in this study who were of an older demographic showed less tolerance for risk than younger CEOs, suggesting that age may be a factor in risk appetite. Younger CEOs had more tolerance for risk, were more innovative with SME lending policies and engaged in SME lending to a larger extent.

"The challenge of SME lending is credit unions will run out of runway unless they diversify. A solution is to innovate through commercial lending (develop policies and processes, quality assurance, automation etc.)"

CEO, large Irish credit union

Such innovation should start with the data assets that credit unions have, namely their loan books. However, data integrity issues are limiting the identification of trends in SME lending.

5.4. Categorising loans remains unstructured

We have already noted an issue arising when classifying microcredit loans, in Irish credit unions. Microcredit loans registered as personal loans are often in fact loans to micro-enterprises or self-employed individuals. In general, as most microcredit borrowers are self-employed entrepreneurs, it is difficult to distinguish whether the loan awarded qualifies for a microloan to the micro-enterprise or a personal loan. This further adds to distorted loan portfolio figures and SME commercial lending figures.[18]

> *"We often see that when a member needs a loan for a business purpose, the loan is underwritten and classified as a personal loan. Why? Many credit unions do not have the expertise to underwrite and document business loans in accordance with Central Bank requirements. Or they simply don't want to go through the bother because they know from experience that the member is solidly creditworthy and good for the loan."*
>
> *Stakeholder interview*

All the same, the resulting mis-classification complicates understanding of the true extent of Irish credit union business lending. Where the business is in fact an individual member, credit unions are far more willing to engage in SME lending than the data suggests.

6. Collaboration amongst CUs to achieve back-office scale

Credit unions have traditionally employed a simple, sustainable, member-focussed business model that is underpinned by effective governance, risk management and operational frameworks, while offering a very limited set of loan and savings products. However, we are now seeing that the business models of credit unions are becoming more complex as the range of product demands from consumers increases and as negative ECB deposit rates impact the ability to pay positive rates for consumer savings.[19]

> *"There is an indication that the business model is becoming more complex so credit unions must specialise to outsourced vendors in areas such as risk, payment services and more recently features such as e-signatures."*
>
> *Stakeholder interview*

Achieving the scale economies to do so has required credit unions to work together in collaborative efforts. The idea is to employ experienced, full-time technical and professional management and staff on a joint basis to obtain the high-level support they cannot afford on their own.

Their models are the Credit Union Service Organisations (CUSOs) that are indispensable features of the credit union movements in the US, Canada, and

[18] European Commission (2003), Microcredit for Small Businesses and Business Creation: Bridging a Market Gap, p12

[19] The Irish Times (2020), Why are banks starting to charge us for saving money? 12 December 2020

Australia. CUSOs enable CUs in those countries to compete head-to-head with commercial banks as full-service financial providers, both to consumers and businesses.[20]

For example, in recent years, Irish credit unions have organised and funded CUSOs such as Payac and CUSOP to provide current accounts, debit cards and related services to their members. These CUSOs assist CUs in obtaining regulatory approval and developing, implementing, and providing ongoing support for payment account services. This includes setting policies, procedures, operating standards and negotiating third-party services and outsourcing arrangements on behalf of participating CUs.[21]

The credit union-owned Solution Centre has developed a suite of products that support and enhance its clients' back-office operations, including lending, marketing, and compliance. Another (partially overlapping) group of CUs have collaborated with the Ireland-based, international financial technology company Fexco in the formation of a joint venture named Metamo. Metamo has the same basic objective as the Solution Centre, namely, to support credit union sustainability through the provision of a range of modernised back-office support services and financial products, including enhanced lending capabilities.

Now, Metamo and the Solution Centre are showing how their collaborative model can help credit unions achieve the scale and expertise they need to safely grow their SME lending.

Both organisations obtained approvals from the Strategic Banking Corporation of Ireland (SBCI) for credit unions they serve to participate in SBCI's programme for State guaranteed Covid-19 recovery loans to small businesses. The guarantee covers 80% of the outstanding balance of qualifying loans made by those credit unions, which means they can safely build their skills in understanding and executing SME lending on a significant scale.

Of particular benefit has been their ability to make much larger SME loans while substantially mitigating their risk. The top performing credit union in one of those groups has issued 80% Government guaranteed SME loans totalling €684,000, of which the largest was for €240,000. All were at a 5.0% interest rate.

Cultivate is an initiative of a group of credit unions that provides short- to medium-term loan opportunities for farmers. It is a result of a collaboration between 26 credit

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[20] Jones, P.A, Money N., Swoboda R., 2017

[21] For example, Payac https://www.payac.ie/about-payac/

unions based mainly in the Midlands, West and South West. The Cultivate farm loan scheme offers farmers unsecured loans of up to €50,000, which can be repaid over a period of seven years.[22]

Such collaboration can be benchmarked against successful programmes elsewhere. Canadian credit union Vancity created a small business loan program to assist workers in the gig economies who struggle to meet the underwriting requirements of traditional loans, such as income verification. They partnered with a Fintech organization to develop an app that used algorithmic decision-making to speed up loan application and underwriting and provide independent workers with a convenient application process and quick decision. In 2018, member adoption of the app-based product resulted in 203 small business loans being processed, totalling $3.8M, with an average loan amount of $38,000. As of February 2019, there had been zero loan defaults.

7. Collaboration with community stakeholders

Collaboration with other organisations in the credit union's community represents another opportunity for accessing platform technologies, sharing sectoral expertise, improving SME lending policies and growing the back-office capability. A prime example in Ireland of this kind of collaboration to facilitate SME lending is the Nurture Fund at Dundalk Credit Union.

The Nurture Fund is an innovative programme launched in 2019 by Dundalk Credit Union in partnership with Louth County Enterprise Fund.

> *"At the Nurture Fund we did not have DNA expertise. Therefore, we thought, who knows local SME lending? Local enterprise offices, so we collaborated with Louth local enterprise board. In essence we leveraged local enterprise office expertise and used their network to drive local awareness. In order to improve the SME lending process, the enterprise office assign a mentor to help applicants with business plans, financial projections etc."*
>
> *COO, large Irish credit union*

The €1 million fund offers €25,000 in loan finance to start-up businesses and €50,000 for established businesses and aims to support the following sectors: engineering, manufacturing, energy and environment, financial services, digital technologies and

[22] Cultivate is an initiative of a group of Credit Unions providing flexible loans to farmers https://cultivate-cu.ie

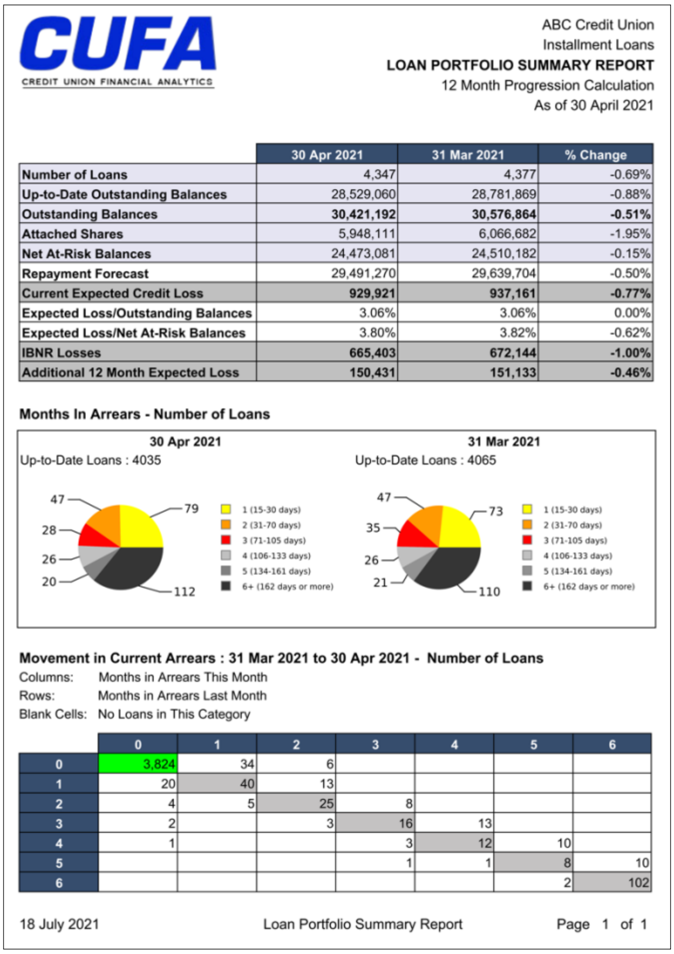
tourism. In addition to their role in providing credit for small businesses and others, the credit unions were critical players in the Personal Micro Credit Loan Scheme.

8. Using data analytics to target SME lending and mitigate its risk

As mentioned in Section 3, credit unions can analyse loan history data to understand their performance and optimise new loan effectiveness. Solutions such as CUFA Lending Analytics[23] or Visualyse[24] were found to aid loan application assessment and decision making.

Among our interviewees there was a sense that credit unions may not be fully capitalising on the opportunity to utilise the power of data to provide insights on loan portfolios, to drive lending decisions, to find cross-selling opportunities for members, and to generally improve the member experience.

There is a wealth of information captured each day by a credit union's core IT system. That data is the raw material for credit risk analytics software, such as CUFA's, which uses mathematical and statistical techniques to objectively quantify risk and to forecast loss in a consumer or business loan portfolio. This means automating the risk calculation for every loan type, and pricing loan products accordingly. The credit scores of borrowers (or the re-sale values of their loan collateral) can be tracked, so that the impact on loan delinquency and recovery rates is visible.



CUFA
CREDIT UNION FINANCIAL ANALYTICS

ABC Credit Union
Installment Loans
LOAN PORTFOLIO SUMMARY REPORT
12 Month Progression Calculation
As of 30 April 2021

	30 Apr 2021	31 Mar 2021	% Change
Number of Loans	4,347	4,377	-0.69%
Up-to-Date Outstanding Balances	28,529,060	28,781,869	-0.88%
Outstanding Balances	**30,421,192**	**30,576,864**	**-0.51%**
Attached Shares	5,948,111	6,066,682	-1.95%
Net At-Risk Balances	24,473,081	24,510,182	-0.15%
Repayment Forecast	29,491,270	29,639,704	-0.50%
Current Expected Credit Loss	**929,921**	**937,161**	**-0.77%**
Expected Loss/Outstanding Balances	3.06%	3.06%	0.00%
Expected Loss/Net At-Risk Balances	3.80%	3.82%	-0.62%
IBNR Losses	**665,403**	**672,144**	**-1.00%**
Additional 12 Month Expected Loss	**150,431**	**151,133**	**-0.46%**

Months In Arrears - Number of Loans

Movement in Current Arrears : 31 Mar 2021 to 30 Apr 2021 - Number of Loans

Columns: Months in Arrears This Month
Rows: Months in Arrears Last Month
Blank Cells: No Loans in This Category

	0	1	2	3	4	5	6
0	3,824	34	6				
1	20	40	13				
2	4	5	25	8			
3	2		3	16	13		
4	1			3	12	10	
5				1	1	8	10
6						2	102

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[23] Cf. CUFA Ltd, p5

[24] Visualyse from Graphical Financial Analysis Ltd, https://www.graphicalfinancialanalysis.com/

"Using CUFA Analytics … we're now able to make more, better loans with the insight it gives us for product design, underwriting, risk-based pricing and marketing focus."

CEO, medium Irish credit union[25]

Data analytics software enables credit unions to keep their boards of directors informed of the key performance indicators in the CU's loan portfolios. It does so by generating standard and bespoke reports to highlight information that might otherwise be masked by the averages. A sample of such a dashboard report from the CUFA system is shown at right.

This same capability Identifies loans that are outliers for purposes of credit control, internal audit, compliance, and overall risk management. CUFA highlights the non-performers and allows drilling down into the detailed history of every loan in the book. This allows loan underwriters to focus on approving loans most likely to be good performers, while avoiding those most likely to go bad.

Data can further enhance a credit union's lending capacity to enter new target markets. As specific skill sets for identified target markets (e.g. SME, agricultural) are essential, careful consideration is needed in developing the lending. Visualyse offers a credit decisioning system for personal, agricultural, mortgage and SME loans.

"Visualyse has become a key strategic partner for NBCU in the continuous development of a more efficient loan decision process, ultimately leading to enhanced Member experience."

CEO, medium Irish credit union

In addition to its analytics, CUFA has also deployed end-to-end loan origination software. The CUFA COMMS system is currently being employed by the Metamo group of credit unions for their SBCI-guaranteed SME lending programme, described in Section 6.

9. Conclusions

This report addresses the opportunity for credit unions to grow their loan books through SME lending.

Lending requirements for SMEs are subject to external macro-economic factors outside their control (e.g., a pandemic halting business in 2020). Inward cash flow may be difficult for SMEs to predict. Because of its nature, this type of lending is critical in

[25] Assets between €10m and €100m

terms of its impact on members' livelihoods, where cash flow interruption over a period of months may result in business failure.

Our data suggests a contradiction at the heart of the credit union lending to SMEs. On the one hand, regulatory requirements are seen as a brake on lending by credit union CEOs. On the other, regulators respond that lending maturity limits have been increased since 2017, and do not understand why more SME lending is not taking place. We frequently heard that the risk appetite for SME lending was low among credit unions managers, yet our data suggests that arrears on loans in 2020, both in value and volume, is similar across personal and business lending (7-8%).

The answer to this puzzle appears to be the relationship between the codification of SME loans, on the one hand, and the expertise required to underwrite such lending, on the other. Loans to members are not always classified correctly, particularly in the case of micro-lending, with data integrity issues arising through uncertainty in the declared purpose of the loan, or ambiguity in the application form.

It is clear that credit unions managers are loyal to the requirements of their members, with whom they have relationships spanning decades. This prompts an aversion to avoid putting member savings and investments at risk, but also a willingness to help longstanding members in difficult circumstances.

On the other hand, those credit unions (for example, Clonmel and Dundalk) with growing SME loan books, have found solutions to accessing the lending expertise required to confidently underwrite SME lending. Dundalk collaborated with the Local Enterprise Board, and Clonmel hired in the appropriate underwriting skills. Sector specific lending schemes such as Cultivate, or scale efficiencies such as lending support from CUDA, hinged on credit unions joining forces with other actors in the market.

Such confidence also derives from an awareness of the potential of data to understand and improve customer engagement, and to complement traditional customer service with data driven insights and decision support.

The next section puts forward our recommendations to credit unions with respect to adopting a strategy for their SME lending business.

10. Recommendations

In light of the requirement for expertise, our research suggests that a shared services approach is essential to assist with underwriting SME loans and securing collateral.

Such a collaborative entity would specialise in credit risk management for SMEs. These services would help to effectively price and manage risky loans, limiting bad debt and managing loan restructuring and forbearance objectively. Such a wholesale credit risk management platform would provide a centralised underwriting capability, with accompanying scale economies in terms of people and systems.

Furthermore, we recommend that credit unions should modernise core service delivery by collaboratively engaging with external infrastructure and customer service platforms. Sharing the workload in this way will allow credit unions to focus on their core competence: developing customer relationships. Using data more effectively to complement their knowledge of SME and micro-enterprise credit requirements, credit unions will be able to identify, develop and promote new sector specific loans.

This change in culture, where investment in underwriting and delivery ecosystems is viewed as strategic and not just a cost of doing business, will equip credit unions to face the competitive challenge from retail banks in the SME and consumer lending markets.

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