



REGULATORY CAPITAL FOR IRISH CREDIT UNIONS: TIME FOR CHANGE?

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CFCFE Conference

INTRODUCTION

- All papers and materials are available on the CEO Forum Website

<https://cuceoforum.ie/>

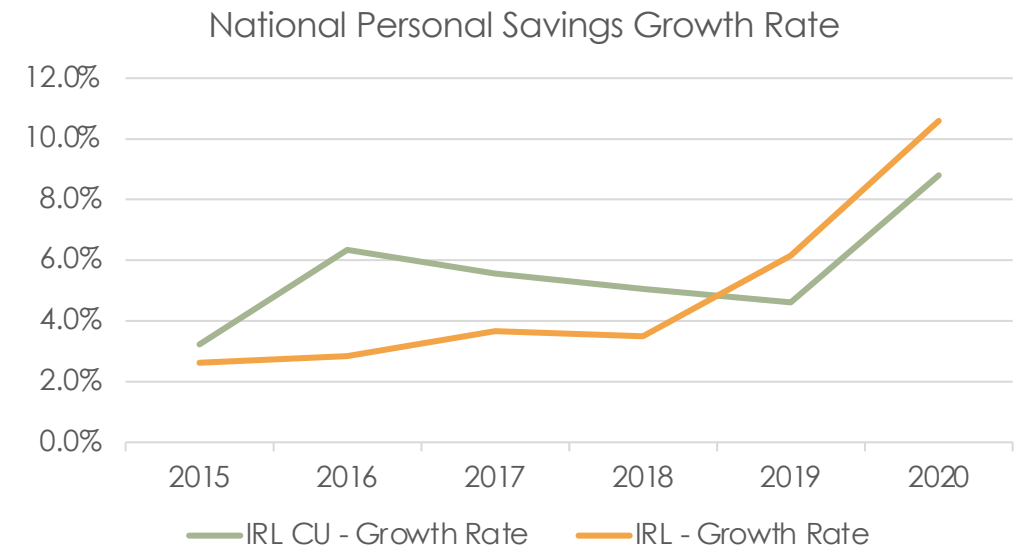
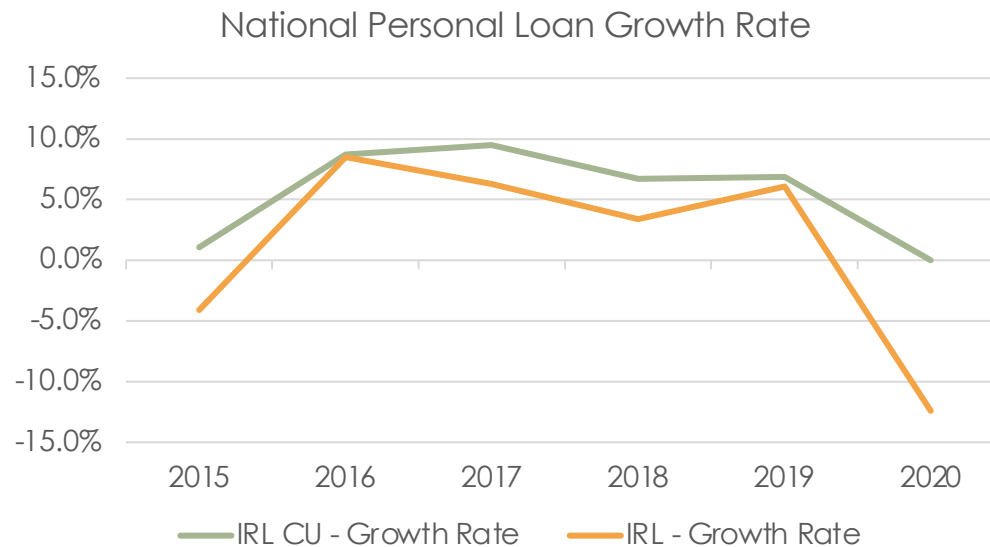
- Acknowledgements
 - Lorraine Greville
 - Michael Ahern
- CEO Forum

Regulatory Capital for
Irish Credit Unions:
Time for Change?

Séan Murray
Lorraine Greville
Michael Ahern

THE STRENGTH OF IRISH CU'S

- The Irish Credit Unions sector is
 - Trusted by members to deliver financial services and described as “A perfect example of a company that genuinely cares about its customers”¹
 - Extraordinarily successful at delivering community financial services²



Source: ¹ Cxi Report 2017; ²(Central Bank of Ireland, 2020) Financial Conditions of Credit Unions and Statistical release - Credit Advanced to and Deposits from Irish Households;

OBJECTS

- The primary objects of a CU are defined by the 1997 Credit Union Act as amended ("the 1997 Act"), Part II 6(2):
 - a) the promotion of thrift among its members by the accumulation of their savings;
 - b) the creation of sources of credit for the mutual benefit of its members at a fair and reasonable rate of interest;
 - c) the use and control of members' savings for their mutual benefit;

Liabilities



99% of
Funding is
on demand

<1 % Current
Account

16% Capital

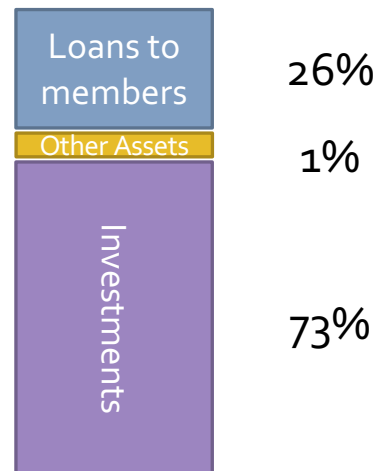
Very low risk funding

€4,500 Average Savings balance
85% of Funding in accounts < €30,000

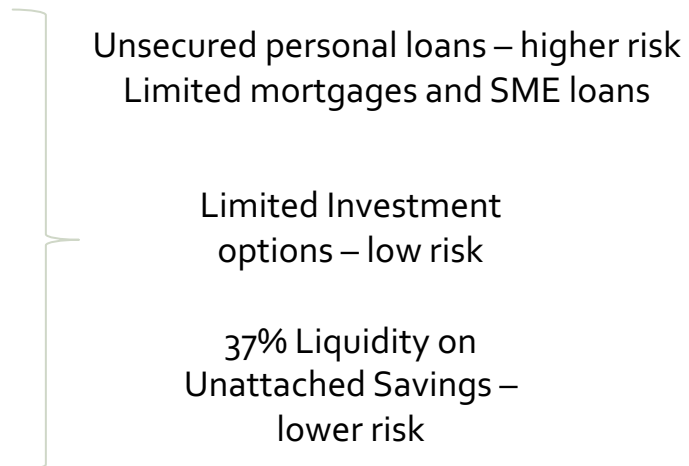
SIMPLE BUSINESS MODEL

- Irish Credit Unions operates a straightforward business model
 - Savings, current accounts and retained earnings
 - Personal Loans; a limited breadth of investments and a small level of SME lending and secured house loans
 - Credit Unions have an average loan to assets ratio of 26.2% as at Sept 2020.

Asset allocation %



Classification



CAPITAL FUNCTION - PROTECTING THE MEMBER

- WOCCU Model rules define Capital as
 - Protect members by providing a cushion against economic shocks or unexpected losses
 - Impairment in the assets of the credit union
 - Possible Losses – arising from risky assets of the CU (Loans & investments)
 - Operational risk
 - Other contingencies
 - Support the growth of the credit union
- Regulators impose minimum capital requirements
 - to promote financial stability and
 - to reduce risk-taking

HOW IS CAPITAL CALCULATED?

- A capital ratio (also known as 'leverage ratio' in Basel III terms) is calculated by dividing capital by total assets.

$$\text{Capital ratio} = \frac{\text{Capital}}{\text{Total Assets}}$$

- A risk-weighted capital ratio applies a risk percentage to the asset in a calculation based on the credit risk of the underlying asset

$$\text{Risk Weighted Capital ratio} = \frac{\text{Capital}}{\text{Risk Weighted Assets}}$$

WORKED EXAMPLE

Assets	€ M [X]
Loans to members	26
Other Assets	1
Investments - High quality liquidity	37
Investment - Long term portfolio	36
Total Assets [A]	<hr/> 100
Comprised of	
Member Funds	84
Capital [C]	16
Capital Ratio [C / A]	16%

WORKED EXAMPLE

Assets	€ M [X]	Weighting [Y]	Risk Weighted Assets [X * Y]
Loans to members	26	100%	26
Other Assets	1	100%	1
Investments - High quality liquidity	37	0%	0
Investment - Long term portfolio	36	25%	9
Total Assets [A]	100		
Risk Weighted Assets [B]			36
Comprised of			
Member Funds	84		
Capital [C]	16		
Capital Ratio [C / A]	16%		
Risk Weighted Capital ratio [C / B]			44%

WHAT IS THE RIGHT LEVEL OF CAPITAL?

- An unresolved International question for Credit Unions

“The supervisory authority must establish and enforce the rules for an appropriate capital framework with which all regulated institutions must comply. The rules should balance cooperative principles and objectives with the need to protect depositors. Accordingly, supervisory authorities will need to consider what meets the criteria for capital carefully and to ensure that capital instruments are able to absorb losses in the event of failure.

When supervisors choose to align capital requirements of credit unions to Basel standards, a simplified approach may be adopted for small or simple credit unions that are not allowed to hold complex financial instruments.

CAPITAL IN IRISH CREDIT UNIONS

No minimum

8% Capital ratio

10% Capital ratio

10% Capital ratio plus
Operational Risk

10% / 12.5% Capital
plus Operational Risk

1966 ACT

- ▶ No Capital requirement
- ▶ CU's required to allocate minimum 10% surplus to reserves.
- ▶ CU's could reduce allocation if >15% reserves held

1966

1997 ACT

- ▶ No minimum capital
- ▶ Establishment of the statutory reserve requirement
- ▶ Same 10% allocation of annual surplus as previously.

1997

LONGER-TERM LENDING LIMIT REVIEW

- ▶ A CU seeking to increase longer-term lending must have a
- ▶ Realised capital ratio of >8%
- ▶ Statutory capital ratio >6%

2007

SI NO 344/2009

- ▶ Increases capital requirements
- ▶ Realised capital ratio of >10%
- ▶ Statutory capital ratio >8%
- ▶ **Includes a provision for Risk Weighted from 2010**

2009

2012 CUCORA ACT

- ▶ Establishes an additional operational risk requirement
- ▶ In addition to the 10% capital ratio

2012

2019 REGULATIONS

- ▶ Establishes a dual ratio of 12.5% for certain Credit Union who engage in House loans

2019

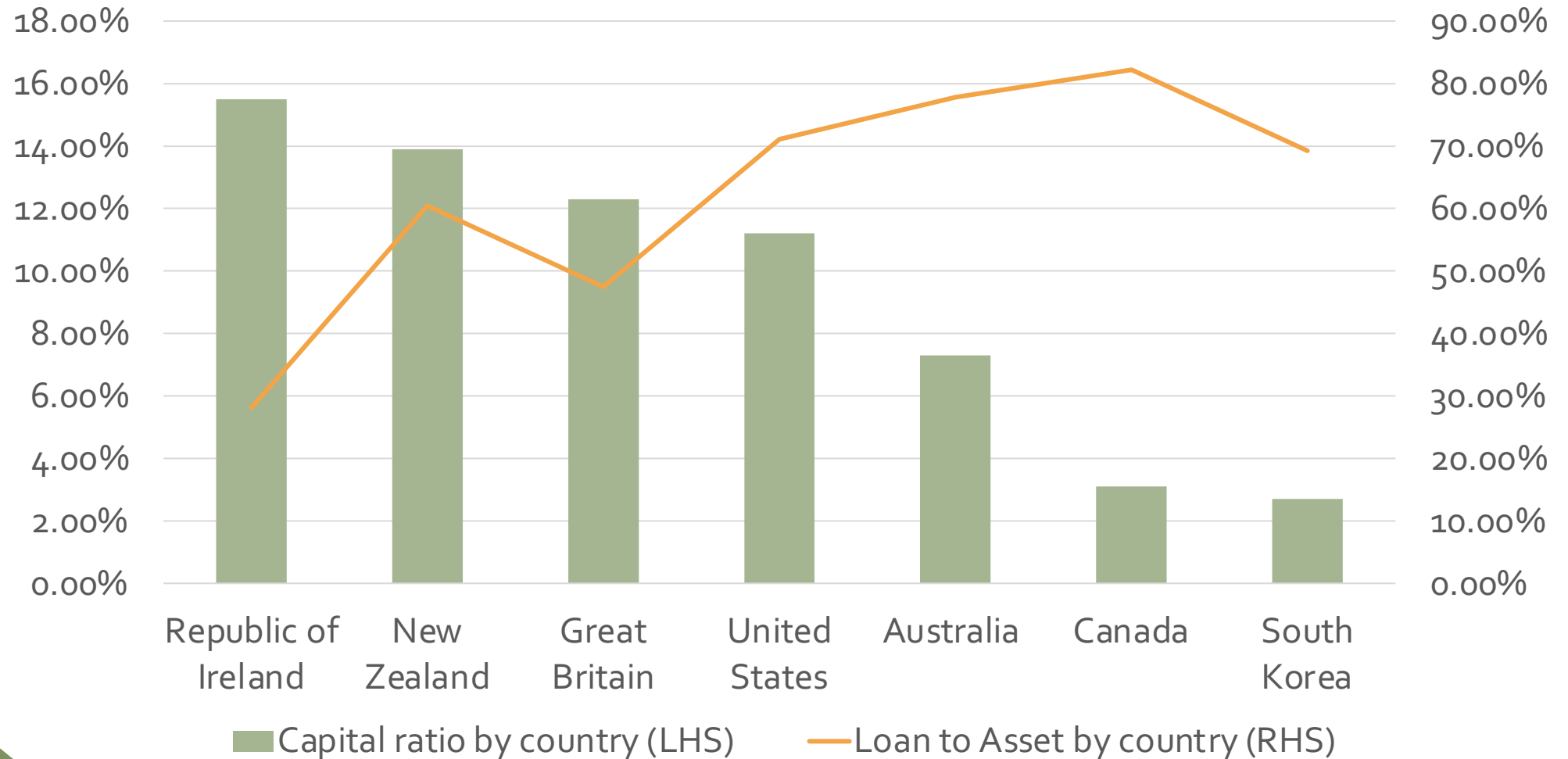
INTERNATIONAL CAPITAL EXPERIENCE



	World Council of Credit Unions	Various international regulatory bodies	Bank for International Settlements
Guidance	Model Rules	National Supervisors	Basel Accord
Minimum Capital requirements	6% Capital ratio	Regulatory capital range from 2% to 10%	10.5 to 13%
Basis for Calculation	Capital ratio	See Over	Risk Weighted Assets
Application	There is no accepted International Standard for Credit Union capital requirements	N/A	Applied Internationally to all complex financial institutions. Acknowledged as not being suitable for most Credit Union systems.
Operational Risk Reserve	N/A	Applied to Irish Credit Unions only	Applied in the Basel III model

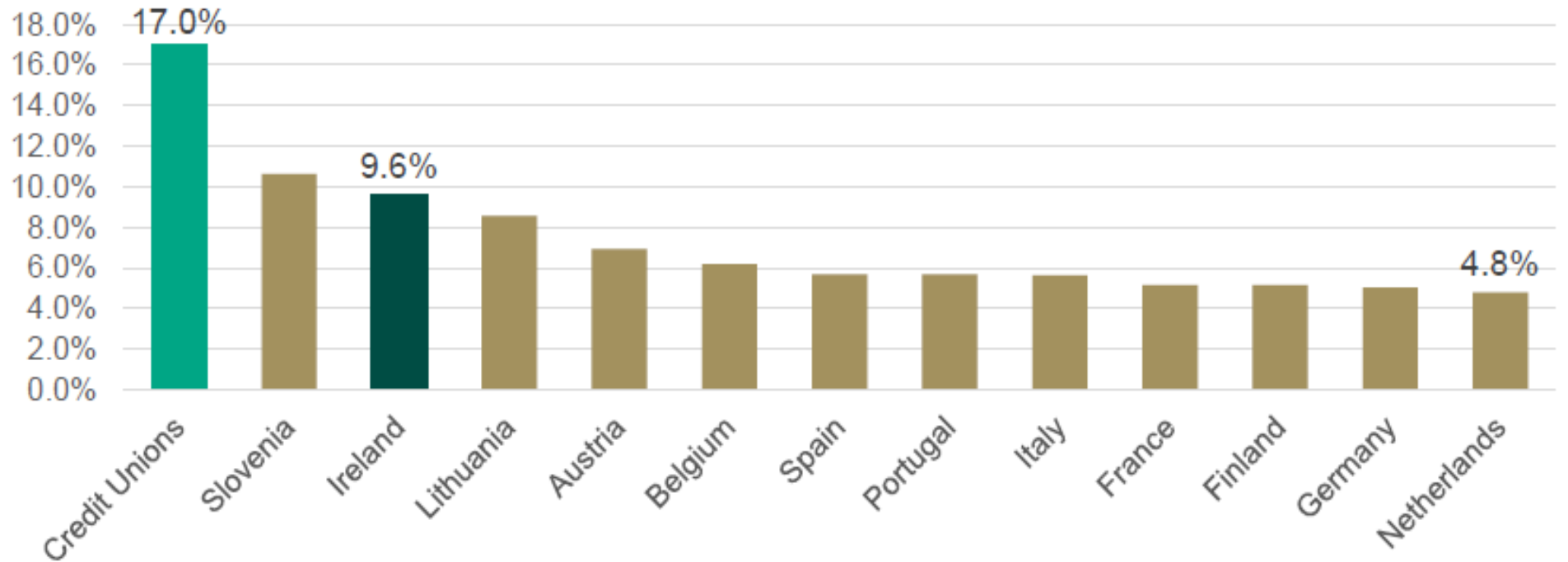
INTERNATIONAL COMPARISON

International Capital Requirement Comparisons



BANKING COMPARISON

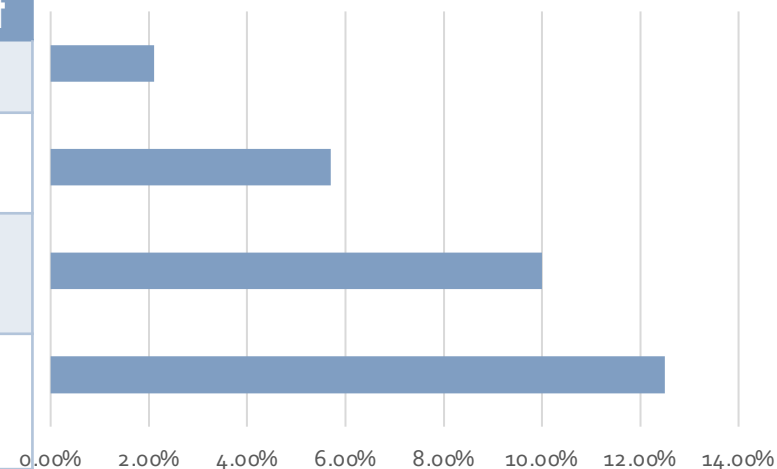
Leverage Ratio %



Source: Department of Finance (2019)

ASSET COMPARISONS

House loan/mortgage assets	Capital Requirement
European bank mortgages ¹	2.1%
Irish bank mortgages ¹	5.7%
Irish credit union house loan requirements ¹	Minimum 10%
Credit unions (extended house Loan limits – CU Total Assets €75 -100M)	Minimum 12.5% ³



¹ Banking capital requirement apply to the mortgage asset only. Lower capital requirement apply to other asset classes (liquid assets for example)

² Credit unions are excluded by regulation from mortgage lending such as 'buy to lets', 'residential investment properties', 'holiday homes' and 'SME business premises.

³ The increased capital requirement of 12.5% applies to the credit unions total assets and not on specific house loan assets.

CURRENT STATE

- Capital Requirements in Irish Credit Unions are
 - Overly conservative compared to international comparisons
 - Excessive compared to the Irish and European banking context
 - Unjustified relative to the risk profile of the Irish credit union balance sheet, and are
 - Putting credit unions at a competitive disadvantage relative to competing financial institutions.
- The current capital ratio is adversely affecting a strategically important part of Ireland's national retail banking system.

ALTERNATIVES CONSIDERED

EXERCISE #1

Basel III

Application of Risk Weighted
Capital requirements

SOLUTION #1

ALR

Application of an Asset Linked
Capital ratio

SOLUTION #2

QAR

Application of Capital ratio on
Qualifying Asset

STRONG IRISH CREDIT UNIONS

- Credit unions have evolved their governance frameworks considerably
- (ICURN, 2019) highlights the emerging risks to credit union capital and acknowledges that the Irish credit union sector operates a “simple business model” and is “well capitalised by any measure”.
- The (Credit Union Advisory Committee, 2016) opined:

“That it is clear that a strengthened regulatory framework as recommended by the (Commission on Credit Unions, 2012), is now in place”.

- Capital change is now overdue that supports these investments

	10 % Capital Ratio	Basel III 11.5% Risk Weighted	ALR Model	QAR Model @ 6%
Total Assets			19,420	
Total Capital			3,010	
Risk Weighting of Asset	N/A	49%	N/A	76%
Capital Requirement	1,942	1,094	993	883
Capital Buffers	1,068	1,916	2,017	2,127
Resultant Capital % Total Assets	10.0%	5.6%	5.1%	4.5%

SUMMARY

- The ALR model is recommended because it:
 - Enhance the viability of credit unions
 - Prioritises investing in safer assets over investing in riskier assets,
 - Strengthens credit union risk management frameworks,
 - Improve credit union risk profiles.
- It will not solve the overall business model challenge
 - it does provide time for exiting initiatives to develop fully and new business models to be developed