A Regulatory Perspective on Credit Union Lending – Strategic Considerations

John Meagher
Registry of Credit Unions – Business Model & Engagement
Business Model & Engagement Unit - Registry

Why a Business Model & Engagement Unit?

- Strategic Plan
  - Legislative requirement (Section 76A Credit Union Act 1997)
  - More relevant than ever in current conditions
  - Expectation that it is a ‘living’ document and drives decisions/actions
  - RCU supervises and rates accordingly (PRISM)
- Guidance issues as appropriate e.g.
  - Long Term Lending – Guidance for Credit Unions (12/2017)
  - Business Model Strategy – Guidance for Credit Unions (02/2019)

RCU’s Vision – ‘Strong Credit Unions, in Safe Hands’
Lending Products/Services – Legislation/Regulation

- Credit unions must comply with **Credit Union Act 1997** and associated Regulations **(S.I. No1 of 2016)**
  - In the matter of **lending** (Sections 35 to 38):
    - ‘...for such purpose as the credit union considers appropriate’
    - ‘...ensure the making of loans does not involve undue risk to members’ savings...’
  - (Central) Bank may prescribe one or more of the following:
    - ‘...classes of lending a credit union may engage in...
    - ‘...limits on the total... that may be lent...’
    - ‘...limits on the concentration of lending...’
    - ‘any other limit that the Bank considers appropriate’
    - ‘...such other requirements as it considers necessary.’

- RCU supervises based on legislation and regulations
- Regulations can change to accommodate sector – e.g. **Consultation Paper 125**
Lending Products/Services – Legislation/Regulation

Product Oversight & Governance (EBA/GL/2015/18)

- Ensure the interests, objectives and characteristics of the target market are met
- Avoid potential consumer detriment
- Minimise conflicts of interest
- Proportionate to the nature, scale and complexity of the relevant business
- Target market product fit and appropriateness
- Target market for which product not likely to meet their interests (financial capability)
- Product testing
- Product monitoring
- Outsourcing (ref CU Act S76J, also CEBS (2006) Guidelines on outsourcing)
Lending Products/Services – Legislation/Regulation

– **EBA Guidelines on Internal Governance’ (EBA/GL/2017/11)**
  - Documented new product approval policy (NPAP)
    - ‘..cover every consideration to be taken into account..new markets, ..new products..make significant changes to existing products or services.’
    - ‘..should set out the main issues to be addressed..regulatory compliance, pricing models, impacts on risk profile, capital adequacy, profitability.’
  - Risk management function and compliance function should be involved in approving new products or significant changes...
Irish Credit Unions - Lending

Republic of Ireland

- €7.3bn in 2008, 51% of Total Assets (€14.2bn)
- €4.8bn in 2018, 28% of Total Assets (€17.7bn)
- 35% share of Irish market in ‘traditional’ consumer loan finance
- Underlying activity:
  - 682,468 loans outstanding,
  - 63% < 3 yrs maturity (32% by value)
  - 96% < 5 yrs maturity (80% by value)
  - 4% > 5 yrs maturity (20% by value)
  - €2.5bn advanced in year to Sep 2018 (589,075 loans)
  - Paper-based, high touch, limited use of technology
  - Growth an increasing challenge:
    » Activity required to maintain position
    » Competitive landscape
    » Cost/capacity constraints
Conceals a wide range of lending profiles at individual entity level and reflected in risk appetite, lending policies and performance.
Key Financial Trends – March 2019

- Loan to Asset Ratio

- Loans and Member Savings

Central Bank of Ireland - RESTRICTED
Trends in Lending – Credit Union by size band

- Operating Expenses to Total Income
  - CAGR 8%

- Credit unions with assets ≤ €100M
- Credit unions with assets €40M to €100M
- Credit unions with assets > €100M

Operating Expenses to Total Income

Other Operational Expenses
Insurance
Salaries and Related Expenses
CAGR Operational Expenses to Income
Competitive Landscape

- Customers expectations
  - Interactions to be simple, intuitive, and seamlessly connected across physical and digital touchpoints

- Banks
  - investing in meeting these expectations but struggle to keep pace, many hampered by legacy IT infrastructure and siloed data

- Unbundling and re-bundling of retail banking
  - The banking relationship is fragmenting even faster in countries with higher digital adoption
    - McKinsey Research

Not only is the pitch changing, the shape of the ball, players on the teams and the rules are also changing.
New Product Launch/Expansion – ‘Traditional’ Risk Considerations

- Guidance Issued 2017 (Long Term Lending)
  - Focus on ‘traditional’ risk considerations, including:
    - Financial
    - Credit
    - Funding & Liquidity
    - Market
    - Governance & Management
    - Operational/Conduct
    - Regulatory/Compliance
New Product Launch/Expansion – Additional Risk Considerations

- Initial ‘spike’ in costs – duplication v elimination, former inevitable, latter more problematic
- Resource allocation – diversion/distraction from core responsibilities
- ‘Learning Curve’ – do not under-estimate, accept and reflect in expectations and forecasting
  - Build capability – over time, accept and reflect in policy, simplicity re limits, exclusions
- Member-focus – balance needs/expectation of all members
- Realism in creation of expectations
- Clarity for all parties, front office staff, lending officers, members, ambiguity leads to confusion, increased workload, possible disaffection (reputation risk)
- Broader sector responsibility – consistency and standards
- Portfolio Management challenges – grows over time, reflect in financial forecasting at outset
- Competitor response – experienced incumbents versus new entrants
- Return on Investment – investment required and must be generated from operations