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Regulated credit unions can thrive

02 January 2011 By Kevin Johnson

A healthy financial system is of vital importance to every one of us, whether as savers, borrowers, or taxpayers, as we are now all significant stakeholders in several leading financial institutions in the country.

Whether you believe the fault for our economic catastrophe lies with profit-driven bankers, ineffective legislators or sedentary regulators, one thing we know is that the many credit union members are among those suffering most from the consequences of what has unfolded.

This presents clear challenges for credit unions as they support their members.

A key issue will be ensuring there is the correct balance between appropriate regulation and the sustainable development of the credit union sector.

Recent media coverage of credit unions has been somewhat sensationalist, which appears to be based on a small number of credit unions experiencing difficulties or an extrapolation of that small minority.

There is a significant cohort of financially strong credit unions: take the members of the Credit Union Development Association (CUDA), for example, with total assets of €1.5 billion, regulatory reserve ratio of 11 per cent (the realised, unrestricted and non-distributable amount held as a percentage of the total assets), total capital of 15 per cent, 100 per cent member funded (no exposure to money markets or ECB), solvency rate 118 per cent (the value of assets over liabilities) and liquidity at 30 per cent (significant level of cash available to the credit union on demand).

There are many other examples of strong credit unions across the sector boasting performances many of our rescued banks could only dream about.

This recession affects most people, manifesting itself through creditworthiness, rising loan delinquencies and growing personal bankruptcies.

It behoves all stakeholders to leverage the strengths and values of credit unions by understanding the extent that changes in the operating environment will affect the nature or direction of their credit union over the coming years. Responsible credit unions can build on their financial and non-financial strengths, develop, flourish and actively tackle these challenges.

To underpin this genuinely ethical and trustworthy financial services sector, the starting point must be the finalisation of a statutory prudential management framework, leveraging the collective financial strength of credit unions.

This comprehensive financial framework has four elements:

* The first element is to ensure that there is an appropriate capital management policy at credit union level to manage the buffer required between a credit union's assets and its liabilities.

* The second is to set up a central liquidity facility, establishing a pool of credit union money from surplus funds that can be used by a credit union that may encounter a short term liquidity need.

* The third is a statutory stabilisation mechanism, operated totally independently from credit unions and their representative bodies, to assist a credit union with short-term difficulties not related to liquidity.

High-level 'stabilisation' powers have been provided to the Minister for Finance under recent legislation, but the question of a statutory, fit for purpose, stabilisation fund needs to be addressed.

Credit union deposits to any such fund should remain an asset of the contributing credit union, and, consistent with established international best practice, clear rules set out in law to ensure the confidence of credit unions and their members.

This absence of any moral hazard allows boards of credit unions to meet a primary duty of not putting their members' savings at risk.

Confidence will be enhanced through a set minimum entry requirement to such a scheme and ongoing participation requirements. It is not acceptable that initial investments would be immediately consumed by any credit unions with long standing problems that require regulatory intervention.

The scope of the deposit guarantee scheme legislation could allow for both aforementioned liquidity and the stabilisation mechanisms to be included in the DGS framework under effective Central Bank control yet ring fenced for credit unions.

* The final element, a founding objective of CUDA, to ensure equitable treatment of Credit Members by having them included in the state deposit guarantee scheme is already in place.

Credit unions are different from banks and, in addition to the above, require a differentiated Prudential and Consumer Protection regulatory approach by the Central Bank.

Such a system of differentiated, competent, statutory regulation properly resourced, removing all remnants of self-regulation, can help to ensure that the financial brand people seem to trust their local credit union can grow and flourish into the future.

Sound corporate governance as well as the qualification of a credit union's board, management and staff is another important part of the future development.

Well founded corporate governance structures have to be in place, specifying the distribution of responsibilities as well as accountabilities among different participants in the credit union.

Knowing the hard facts of the business is important for acting effectively and efficiently.

Completion of a bespoke diploma level educational programme, such as the Credit Union Advisor qualification, is vital to enhance the technical knowledge of management and staff. Similarly, the directors' and supervisors' development programme is an important education tool for those individuals charged with the governance of their credit union.

Where proper measures are in place, credit unions should be given greater flexibility.

CUDA urges a move away from the one size fits all approach, constantly dogged by a lowest common denominator practice.

Unfortunately, as predicted by CUDA, this has been experienced with the ill-thought-out and poorly delivered changes in 2010 to Section 35, which relates to the rescheduling of loans.

This change is causing significant difficulty for credit unions and their members and should be revisited as part of the ongoing strategic review. Credit unions can further help themselves by redefining and re-focusing their business model and developing a standardised best practice approach to directing and managing their credit unions.

Hopefully, the opportunity will be taken in the ongoing strategic review of the sector, on behalf of the Minister for Finance, by the Registrar and Grant Thornton, to understand the strengths of the movement, to recognise the significant cohort of strong credit unions that exists today despite the meltdown in the wider financial sector and to recommend modernising legislation that creates an appropriate and flexible framework for credit unions to fulfil their core purpose.

Kevin Johnson is chief executive of the Credit Union Development Association which is a representative association for credit unions with a combined asset base of over €1.5 billion and over 250,000 members

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