



# The value based Credit Union model

the alternative to  
consumer banking  
in the 21<sup>st</sup> Century

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# Contents

Executive Summary .....	4
Introduction .....	7
CUDA’s Statutory Prudential Management Framework: A comprehensive cooperative four tiered financial framework .....	10
1. The Deposit Guarantee Scheme – the Framework’s Foundation .....	10
2. Central Liquidity Facility – the self help ethos .....	11
3. Appropriate Capital Management Policy – acknowledging divergence of Credit Unions .....	12
4. A Statutory Stabilisation Scheme – The final stage .....	13
Market and operational perspectives of the future strategy .....	14
Effective and enabling legislative and regulatory system needed.....	17
Summary.....	18

## Executive Summary

The Core purpose of Credit Unions is to make the lives of their members, their families and their communities better by providing financial independence through access to financial services, financial products and financial education. The Credit Union Development Association [CUDA] exists to act as a catalyst for the growth, development and expansion of progressive Credit Unions, and to help them to deliver their promises to their members.

In this time of global financial crisis, Credit Unions need to be clear on what has to be done better, what has to be done differently, how they will know they are achieving this and what is being done to move the right measures in the right direction. A robust plan, focused on members and sound business economics can be achieved by prefacing each decision with a simple question, what problem will this solve for members? There are three core elements to such a plan:



1. The introduction of a Statutory Prudential Management Framework that leverages the financial strength of the Movement to facilitate the next growth phase of progressive Credit Unions in Ireland;
2. The crafting and re-definition of Credit Union business strategy and positioning together with the further modernisation and up-grading of Credit Union governance and operations to better mirror best practice and market requirements;
3. The introduction of an enabling legislative and regulatory framework that will replace the current out-dated 'one size fits all' approach.

The successful implementation of this framework is built on the support of progressive Credit Unions, legislators and regulators. In parallel with this, much can be achieved by Credit Unions themselves through organised collaboration with each other to implement the following key deliverables:

1. Singular focus to serve members and guided by their welfare and best interest – both in good times and bad times;
2. Adopt member value based principles of pricing;
3. Concentration on core business of savings and loans;
4. Become a funding source for the micro-business sector;
5. Achieve operational excellence through cooperation and collaboration across Credit Unions;
6. Model for democratic governance;
7. Demonstrate commitment to the ongoing professionalism;
8. Demonstrate absolute solvency.

Starting with the end firmly in mind, that it is all about the members of Credit Unions, CUDA believes that its strategic framework will deliver consistent value products and services, relevant communications, appropriate guidance and advice, while making it easy for members to do more and more of their business with their Credit Union, who in turn will

never let them down and will share the benefits achieved with them. Credit Unions can enhance the current unique relationship that exists between members and their Credit Union and be the financial institution that people can consistently trust, and become the provider of choice for financial needs.

# **The value based Credit Union model - the alternative to consumer banking in the 21<sup>st</sup> Century**

## **Introduction**

When Lehman Brothers Investment Bank collapsed in September 2008, it triggered a series of events around the world which resulted in the failure of the global banking system over a relatively short period of time. Much has been written and said in recent months questioning the financial stability of Credit Unions. Credit Unions are not immune from the global and national economic winds of recession, and indeed many have been adversely affected by them. However, on aggregate the Credit Union movement is reasonably strong in terms of both their reserve and liquidity positions, as the Minister for Finance and the Registrar of Credit Unions have both stated.

The reasons for Credit Unions being in a more healthy status than banks are manifold. Yet, we believe that the answer mainly lies in the basic business model that the banking system across the world adopted and expanded over many decades. This model is based on the single premise that the only stakeholder that needs to be satisfied is the 'shareholder' and the returns necessary to achieve this can only be earned by the maximisation of 'profit'. The creation of 'shareholder value' in the shortest possible timeframe was the key driver in the banking model over recent decades. This model disregarded ethical or value-based factors. Large wealth was created but not distributed on an equal or fair basis.

The Credit Union model is fundamentally different from the 'Banking Model' in that it is value-based and built on the well established principles of equality, equity and mutual self help. The primary motive is to provide an economic and social service to members (i.e. owners) and their community.

No pressures exists to satisfy one stakeholder in the fastest time possible so no conflicts exist as in the 'Banking Model'.

	Banking Model	Credit Union Model
Main stakeholder	Shareholder	Credit Union members
Objective	Shareholder Value	Serve members
Basic principle	Maximisation of profit	Value-based and social model, sustainability
Timeframe	Short-term	Long-term

This approach has led to the success of the Credit Union Movement over 50 years in Ireland. Little or no support was provided by government and certainly no bail-outs were ever received. The growth and development of the Credit Union Movement is proof that a value-based economic and social model rooted in local communities can succeed and lead our economic recovery, which in turn benefits all members and the community at large.

Against the current backdrop of unprecedented pace of economic decline and the near collapse of the main Irish banks, the Credit Union sector can step up to the plate for ordinary people by redefining its business strategy and prudential configuration to ensure that it not only maintains its relatively healthy and stable financial position, but that it can also meet the saving and borrowing needs of a growing membership who are increasingly turning to a brand they can trust – their Credit Union. Credit Unions need to ensure that they have a clear strategy, consisting of a framework of choices, that define the nature and direction of the Credit Union sector. This strategy must be visionary, product and market driven. It must cater for those Credit Unions who wish to remain within the current 'traditional Credit Union' model but critically it has to be enabling for progressive Credit Unions who wish to prudently grow and develop in line with the changing needs of their members and communities and who wish to release the significant untapped potential of Credit Union in Ireland.

In CUDA's view this brave new world for Credit Unions in Ireland has three key interlinking elements:

1. The introduction of a Statutory Prudential Management Framework that leverages the financial strength of the Movement to facilitate the next growth phase of progressive Credit Unions in Ireland;
2. The crafting and re-definition of Credit Union business strategy and positioning together with the further modernisation and up-grading of Credit Union governance and operations to better mirror best practice and market requirements;
3. The introduction of an enabling legislative and regulatory framework that will replace the current out-dated 'one size fits all' approach.

## CUDA's Statutory Prudential Management Framework: A comprehensive cooperative four tiered financial framework

CUDA proposes a **comprehensive financial framework** that enhances the Credit Unions' financial management efficiency and effectiveness while at the same time ensuring a maximum of prudence. This innovative proposal is based on an understanding of international best practice, appropriateness to Irish Credit Unions and a sustainable workable solution.



### 1. The Deposit Guarantee Scheme – the Framework's Foundation

The foundation underpinning CUDA's recommended financial framework is the Government Deposit Guarantee Scheme. Since its foundation in 2002, CUDA has campaigned for a statutory savings protection scheme that would afford all Credit Union members the same degree of protection as bank depositors. The **State Guarantee of up to €100,000 per Credit Union member** was introduced in September '08, despite resistance from other parties, both within the Credit Union movement and from outside of it.

While the revised Deposit Guarantee Scheme [DGS] ensures peace of mind for all Credit Union members, however, it is only there as the ultimate safety net. To limit the potential for it ever to be relied upon there are other elements of the financial framework that need to be implemented.

## 2. Central Liquidity Facility – the self help ethos

Half the country's families have their savings in Credit Unions, and Credit Unions account for a substantial share of the Irish financial sector. It can be argued that the provision of liquidity to maintain the stability of the financial system (including Credit Unions) is a core obligation of the central bank. The Registrar of Credit Unions has stated that there is between €2.5bn and €3bn liquidity available within the Credit Union sector, therefore, consistent with the Credit Union ethos of self help, there is a great opportunity to determine an internal solution that will be both workable and sustainable, and a real front stop to the statutory guarantee that is in place. However, past experience informs us that for solutions to be sustainable they must have a statutory basis and must be appropriately regulated.

In the CUDA proposal Credit Unions will **deposit a portion of surplus funds** into this Central Liquidity Facility, but critically, these deposits will remain on their balance sheet as an asset of the Credit Union and will attract a competitive return. In keeping with established international best practice, **governance will rest with the Financial Regulator**, ensuring that it is backed by the full faith and credit of the Government. **Access to liquidity will be based on withdrawals, and short term credit facilities through direct application** to the scheme's Regulator. For complete transparency, loan rules will be approved by the Department of Finance and the Financial Regulator, after consultation with the Credit Union representative bodies. By these means, the Central Liquidity Facility is legislatively based, transparent, credible, fit for purpose and sustainable over the long-term.

A Central Liquidity Facility as described **implicates important benefits**, both for the Credit Unions and for the State:

- The Central Liquidity Facility is a completely self funded mechanism with no added financial strain on individual Credit Unions.
- The deposit remains on each Credit Union's balance sheet as an asset.

- Credit Unions have full access to funding in the event of liquidity emergency and, therefore, significantly reducing the potential to call upon the State Guarantee directly.
- The Central Liquidity Facility is a credible, workable and sustainable solution that is owned by Credit Unions but operated and regulated independently of them.
- The Central Liquidity Facility is open to all Credit Unions in Republic of Ireland.
- The Central Liquidity Facility should make use of operational expertise from within existing State bodies.
- A short timeframe is needed to implement this Central Liquidity Facility.

In implementing the proposed legislatively based (but Credit Union owned), independent central liquidity mechanism, the Credit Union movement, through the cooperation of key stakeholders, can demonstrate positive leadership, act as an example to other sectors within the financial services industry, while also providing a positive outcome to counter the negative media coverage recently afforded to Credit Unions.

### **3. Appropriate Capital Management Policy – acknowledging divergence of Credit Unions**

A central element of CUDA's financial framework is an appropriate Capital Management Policy that manages the buffer between a Credit Union's assets and its liabilities, indeed the insufficient size of this buffer has been at the heart of the banks problems. The Registrar's recent proposal to increase the reserves of individual Credit Unions, is a welcomed initiative, however, it is a 'one size fits all' model that does not acknowledge the divergence in asset quality in Credit Unions and that could contribute to significant instability in the sector and loss of public confidence. Therefore, while the approach recommended correctly rewards Credit Unions for their bad debt provision,

we propose that it should **also factor in a risk weighting of assets** to reflect the risk profile of the Credit Union, i.e. loan security and investment type (e.g. Sovereign guarantee, equity exposure etc). Thus, CUDA have developed a simple **Reserve Strategy Model** that reflects

- the asset quality and
- risk profile within each Credit Union, while also
- acknowledging and driving the quality of governance and professionalism in Credit Unions.

The advantage of such strategy is that it appropriately treats the diversity of the Credit Union sector. This ensures that strong stable Credit Unions are not disadvantaged, while weaker Credit Unions are appropriately dealt with based on a level of statutory reserve which would be increased proportionally and incrementally depending on the underlying risk.

This approach will reward Credit Unions that demonstrate their ability to prudently and innovatively 'trade up' their reserve levels. CUDA acknowledges that this approach will add a degree of complexity, however, time afforded to getting this right now will benefit Credit Unions into the future. The choice of inappropriate capital reserve levels would not serve to protect or underpin the future development of the sector if set too low and could have competitive implications if set too high. Adopting this approach ensures that Credit Unions which are robust and in a position to grow will not be hampered by overly restrictive or inappropriate reserve requirements.

#### **4. A Statutory Stabilisation Scheme – The final stage**

The final element of the financial framework demonstrates CUDA's support for the establishment of an appropriate Credit Union wide stabilisation scheme, one that is based on an independent statutory basis using international best practice. Similarly to the liquidity mechanism, individual

Credit Union's will need to contribute to the stabilisation fund, but critically these deposits will remain on their balance sheet as an asset.

Where a Credit Union has a problem, that is not a liquidity problem, the Financial Authority will be positioned to select from an agreed spectrum of solutions, including access to the fund to resolve the matter appropriately. This may range from a loan with specific conditions attached to a merger with a 'stronger' Credit Union. The rescuing Credit Union should not be penalised or weakened by such a merger and the Regulator may issue a financial grant to ensure no dilution.

## **Market and operational perspectives of the future strategy**

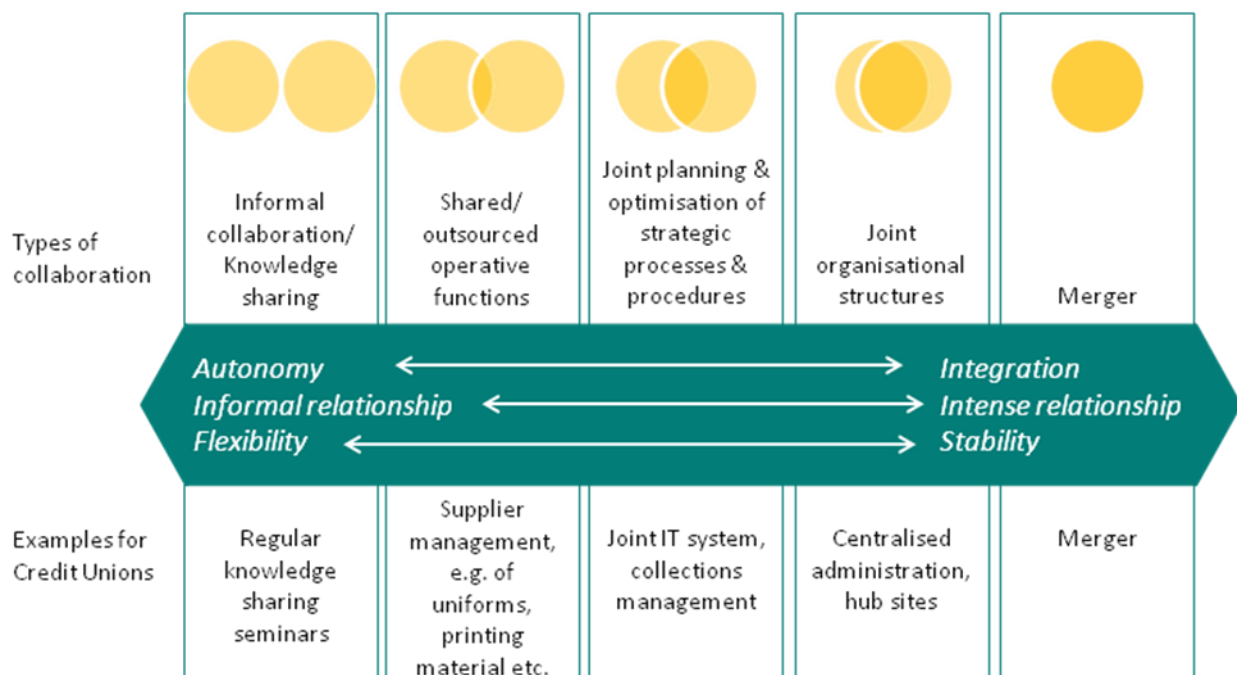
In its 'Call to Action' document, issued in November 2006, CUDA called for a full root and branch review of Credit Union legislation. The current 1997 Act, as amended, is based on the 1966 Act and is insufficient to meet the needs of an evolving sector operating in a dynamic market. This review is needed urgently if Credit Unions are to be allowed play their part, and the vital role they can fulfill, in the national economic recovery.

To assist drive the review, CUDA have addressed the need for the Credit Union sector to have a clear vision, and clarity on what has to be done differently and done better to achieve the vision. CUDA has also considered how Credit Unions will know they are doing things differently and better and ensuring that appropriate initiatives are underway to move the right measures in the right direction.

Credit Unions have consistently demonstrated that they are on the side of their members, and as a result have earned members trust. Building on this strong base, positions Credit Unions to be Ireland's only truly trusted financial services brand. This can be achieved through a combination of external enhancements [such as appropriate legislation, enabling regulation,

stakeholder role definition] and internal enhancements [such as alignment of processes between Credit Unions, improved product management, marketing and brand management, back office processing, IT, new member acquisition, volunteerism\ succession planning, competency levels].

Credit Unions are successful based on co-operative principles, this success can be improved through greater cooperation across Credit Unions. CUDA have developed a spectrum of collaboration to facilitate Credit Unions develop strong business relationships with each other, while also providing Credit Unions with the option to evolve at an appropriate pace. An essential element of the success of this approach will be the facilitation role played by CUDA, which has no financial interest in the collaboration, rather it is fulfilling its purpose to act as a catalyst for the growth, development and expansion of progressive Credit Unions, and to help them to deliver their promises to their members.



The implementation of the cooperation processes can be accelerated by understanding where best practices exist and utilising them in more Credit

Unions, greater use of technology to facilitate this and also by identifying suitable partners, with proven expertise, to provide efficient and effective delivery of outsourced services.

The actions to achieve successful implementation of this part of the framework will require completion of the following steps:

- Start with a vision for the sector [what Credit Unions are setting out to achieve],
- Adapt the CUDA recommended strategy that provides constancy of purpose which, in turn, will direct daily decision making by Credit Unions,
- Work on implementing the strategic themes [What do Credit Unions need to do differently or better to achieve the vision?], that will modernise more practices within Credit Unions,
- Adopt member based measures [how will stakeholders know that Credit Unions are doing things differently and/or better?],
- Implement the initiatives that Credit Unions must execute to move the measures in the right direction,
- Ensure that all decisions are simplified by addressing the question... 'what problem are we solving for Credit Union members?'

## **Effective and enabling legislative and regulatory system needed**

To ensure the healthy position of the Credit Unions into the future and to avoid the same failure befalling them as experienced by banks, an effective and enabling legislative and regulatory system is needed. CUDA unreservedly rejects self regulation and accepts that after genuine consultation and thorough analysis, the prescription of policies for Credit Unions is ultimately a matter for the legislator and statutory regulator.

However, Credit Unions deserve and need modernised legislation to underpin the growth and development of the Credit Union sector, with effective and enabling supervision by the Financial Regulator completely replacing all forms of industry self-regulation. Such a system needs to take into account the prudential perspective of regulation but also foster enabling relationships with the sector, ensuring that stakeholders understand their respective roles and work together to cultivate and role model a genuinely ethical and trustworthy financial services industry in Ireland, that provides products and services that are both fit for purpose and valued by Credit Union members.

CUDA is committed to implementing this new strategic framework for its members and believe that this is urgent, that significant elements of it can be achieved within 12 months, and that the full framework achieved within 36 months.

To facilitate the necessary change, the Credit Union sector needs the support of legislative change as the platform:

- Overhaul the Credit Union Act '97 [as amended];
- Evolve from the 'one size fits all' approach to legislation and regulation;

- Ensure that Credit Unions do not outgrow new legislation in 10 years, what is required is modern enabling legislation with a perspective of 50 years.

Ensure that 'political' considerations do not detract from meeting the financial needs of members of Credit Unions.

## Summary

CUDA, an incorporated legal entity, that is a progressive representative and development association, working on behalf of member-owned, member-directed and professionally managed Credit Unions, has developed a vision and strategy for the Credit Union sector that consists of a financial and an operational framework that integrates three different elements. The strategic plan developed with their members focuses on the **prudential perspective**, ensuring the sustainable financial health of a Credit Union. It includes a **market and an operational perspective** that reflects the main objective of the Credit Union – to serve their members – and that allows the Credit Unions to develop synergies that improve both the effectiveness and efficiency of their business and enable them successfully cope with the challenges of today's market. The third element focuses on an **enabling legislative and regulatory framework** that will replace the current outdated 'one size fits all' approach.