A discussion on the PRA consultation – Reform of the legacy credit union sourcebook (CREDS consultation)

Notes of meeting held on 08 September 2015, Committee Room 17, Palace of Westminster

Alan Brown MP, opened the meeting by welcoming those assembled and introduced the panel consisting of:

- **Martin Stewart the Director of Banks, Building Societies and Credit Unions for the Prudential Regulatory Authority (PRA)**
- **Mark Lyonette the Chief Executive of the Association of British Credit Unions Limited (ABCUL)**
- **Brian McCrory President of the Irish League of Credit Unions (ILCU)**

Martin Stewart thanked the officers of the APPG and ABCUL for hosting the meeting and set out the background and the challengers of the consultation:

- **Martin noted the diverse size of credit unions in both assets and membership and importance to have a sound but flexible regime.**

- **He also noted that the old legislation, the Credit Union Act 1979 was designed for small and traditional credit unions and not for the range of credit unions that exist today and that the reform of this legislation provided credit unions greater powers such as raising capital through deferred shares.**

- **Talking about the CREDS Consultation Martin stated that the PRA does not seek to change 3% minimum capital requirement for the smallest credit unions. However, the Credit Union Expansion Project (CUEP) and Credit Union Service Organisation for Payments (CUSOP) are examples of credit unions wanting to expand whilst others are resistant to change and want to remain traditional credit unions.**

- **Martin stated the need for the PRA to develop a supervisory approach that is flexible for all kind of credit unions and acknowledge that credit unions use volunteers, particularly volunteer boards.**

- **Whilst Martin acknowledged the good work that trade associations do in improving governance in the credit union sector there have also been failures. He recalled an incident where a credit union in difficulties told their members to phone the PRA and stated whilst the PRA is not a zero failure regulator credit unions must be resolved in an orderly manner.**

- **Martin stated that he believes that no member should lose deposits in a credit union, stating his belief that if a large credit union with a large number of members with deposits over the FSCS protection limit failed this would cause a domino effect that would undermine and cripple the sector.**

- **Martin states the proposed regime indentifies higher risk in relation to size and activity of the credit union.**

- **Martin noted the need for additional investment powers; however, the PRA believes this must be balanced with further regulation and the holding of additional capital. Whilst he recognises that some of this holding would hurt the growth of credit unions, the PRA believes that larger credit unions can meet the 10% requirement.**

- **Martin also acknowledged the large transition necessary from 5% to 10% and welcomed feedback in this area for transitional arrangements.**

- **Another potential risk for Martin was the provision of payment services, which if done badly could pose significant risks to members and credit union reputation, although if done well would be a positive development for credit unions.**

- **Martin stressed that the PRA are engaging with credit unions and the trade associations and are still encouraging feedback, particularly on the practical implications of the changes.**

Mark Lyonette spoke next thanking Alan Brown for chairing the meeting at short notice and Martin Stewart for always constructively engaging with the sector.

- **Mark noted that Martin also chairs the International Credit Union Regulatory Network and has a background in Mutuals. ABCUL understands that in many ways the overall direction of the proposals is due to the commitment to the mutual sector.**

- **Mark welcomed the abolition of the Version 1 / Version 2 split, and the new ability the dynamically opt-in to higher regulation and additional activities.**

- **Mark also welcomed the introduction of WOCCU PEARLS ratios following in ABCUL's footsteps who introduced these ratios to members in 2001/2002. Mark noted this was farsighted by ABCUL at the time and had secured sponsorship from Barclays to do this.**

- **In addition, Mark highlighted the benefits of removing the 2% general provision for bad debt and increased focus on governance in the new regulatory regime.**

- **However, Mark acknowledged that the new regime has a lot of unintended consequences and outlined some of the associations concerns:**

  - **The cap on deposits set at the FSCS protection limit (£75k) is unfair and would hamper credit unions in the long term. The reputational risk of a minority of people losing deposits pales in significance to the 2nd rate deposit taker status that would be placed upon credit unions. The regulator would be encouraging the idea that credit unions are unsafe.**

  - **Mark also highlighted that 10% flat capital ratio would be a significant barrier to growth in the credit union sector; credit unions working in low-income neighbourhoods would have to become incredibly profitable to reach the new requirements. These credit unions would not be able to do this.**

  - **Mark used an example of a credit union with £2.5 million in assets, £150,000 and 6% capital. This credit union is growing at 16% and expects to reach 10,000 members in 2 years. In order to achieve 10% capital and ensure an adequate buffer the credit union would have to generate a profit of £400,000 which would be impossible.**

  - **The capital requirement does not affect so much the credit unions that are already well capitalised but those below 10% who are growing. Ireland is the only developed country with capital requirements as high.**

  - **Another issue for Mark was the mis-calibration of the PEARLS ratios which are designed to set benchmarks and gold standards leading to unintended consequences when they are used as regulatory minimums. Such consequences might includes press coverage that, for argument's sake, 30% of credit unions are not meeting regulatory targets, targets which by definition not many credit unions could hit all at the same time.**

The next panellist to speak was Brian McCrory from the Irish League of Credit unions representing over 100 credit unions in Ireland.

- **Brian stated that none of the proposals, except of the removal of the 2% general provision for bad debt, have any benefit for the growth of credit unions.**

- **Brian also made the point that WOCCU capital ratios are a target and not a minimum threshold and would lead to over capitalisation not seen anywhere else in the financial services sector. Brian could not see any underpinning rationale to the requirement. Brian also stated that there is no indication from the regulator of what will happen if a credit union does not meet the capital level.**

- **Brian then detailed issues with a number of the regulatory minimum ratios contained within the new CREDS proposals:**

  - **For Brian, the ratio requiring net loans to remain below 80% of assets and to stay above 40% should be removed in its entirety as they are arbitrary figures with no logic or rationale behind them. Part of credit unions task is to serve the unbanked and the underserved. If they were not to meet to 40% limit, they would not be able to use CUSOP and the people at the very bottom would be cut off from these services.**

  - **This ratio takes no account of the current trading conditions for credit unions, not just in Ireland but around the world. Not meeting these ratios would curtail the use of the most profitable activities such as mortgages which are also useful to members.**

  - **In relation to requirement that non earning assets must not exceed 10% of total assets, Brian states that the definition of non earning assets is unworkable and needs to exclude cash at bank and prepaid expenses. Many credit unions would fail this requirement.**

  - **Brian also expressed that the recommendation that credit unions cannot be trusted with funds over the compensation limit is an anti-competitive introduction. He asked the question of whether there should be a €100,000 savings limits in banks as singling out credit unions indicates to the public that credit unions cannot be trusted with members' money.**

  - **In relation to the 10% capital requirement Brian stated that he would wish to see a risk adjusted capital ratio for credit unions over 10 million in assets as the flat capital requirement would be hugely costly for some and unobtainable for others.**

- **Brian McCrory stated that he is not against appropriate regulation but is opposed to some of these particular regulations and transitions. He expressed his regret that he could not be more positive about the CREDS reform.**

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Martin Stewart commented that one thing that seems to be acknowledged in the sector was a need for change. The audience was then invited to participate in the discussion.

- **David Morgan the Treasurer for London Community Credit Union questioned how comparable the capital requirement is in comparison to the 'too big to fail' banks which should logically hold more than any other institution. Barclays holds only 4% capital whilst his own credit union by the same standard holds 8.9% but is being told that it is not good enough.**

- **Bill Hudson from Access to Credit Unions for Everyone (ACE), said that some credit unions are confused by the ratios they are required to meet. Out of a sample of 20 ACE credit unions none met every single target ratio.**

- **Caroline Domanski, CEO of No1 Copperpot Credit Union, made the point that the requirement for a 6% income from the loan book steered credit unions to a different kind of customer.**

- **Mark Lyonette was keen to stress that the PRA had been very open to engaging with credit unions on the consultation paper; the only regret about the whole process is that the regulator would have sat down with the sector before the consultation to shape the proposals.**

- **Martin Stewart replied that structure of the Bank of England prevents the PRA engaging in pre-consultation**

- **The Vice chair of the Group, Peter Grant MP, expressed his hope that there would be an explanation of where the targets end up being set. Peter also commented that even with the current 8% capital requirement when a credit union reaches 10,000 members there is a large step up (from 5%). He stated that we do not want a regime where the 10,000th member is being turned away due to this hurdle.**

The Chair of the All-Party Parliamentary Group, Robin Walker MP, apologised for his earlier late arrival due to being detained for parliamentary business and thanked all the attendees for coming and closed the meeting.

For more information contact the Group secretariat, ABCUL.