# The Financial Co-operative System in Ireland

**Olive McCarthy, Sharon Farrell, and David Hewson**

**Abstract** The financial co-operative system in Ireland is comprised mainly of credit unions. The Irish credit union movement includes over 520 individual credit unions with a combined asset base of over 16 billion euros, total membership of over 3.6 million people, total savings of over 13 billion euros and total lending of over 4.5 billion euros. This chapter explores the current size, structure, operations and challenges of the movement across two jurisdictions: Northern Ireland and the Republic of Ireland. This is a particularly difficult and complex time for credit unions in both jurisdictions as they face significant regulatory, legislative and structural changes.

## 1 Introduction

This chapter examines the financial co-operative system on the island of Ireland. The focus of the chapter is on the Irish credit union movement as this is the main form of financial co-operative in existence. Until recently there were two building societies in operation in the Republic of Ireland but these have since been nationalised following the restructuring of the banking sector. A small number of building societies continue to operate in Northern Ireland.

While the Irish credit union movement differs between Northern Ireland (NI) and the Republic of Ireland (RoI) in terms of legal and regulatory jurisdiction,

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the majority of credit unions across the island have been united since their establishment through a common umbrella body and have acted largely as a united movement. The credit union movements in both NI and the RoI are undergoing significant changes at present, some of which are discussed later.

## 2 Establishment and Evolution

Nearly every town and city in Ireland has a credit union office serving many of the financial needs of its members. The Irish credit union movement has one of the highest membership penetrations of all credit union movements throughout the world with about one in every two citizens holding credit union membership. Most Irish credit unions are community based and offer services, such as savings and loans, to meet the needs of their members.

Credit unions first emerged in Ireland in the late 1950s primarily as a response to a lack of adequate banking facilities for ordinary people.[1] At that time, Ireland was characterised by high levels of poverty and unemployment. Access to savings and loans services was difficult for those with little or no income as conventional banks chose to confine their dealings to more wealthy customers. This led many to resort to moneylenders and pawn brokers for credit, who usually charged usurious rates of interest. The foundations of the Irish credit union movement are mostly attributed to the pioneering efforts of Nora Herlihy, a school teacher, who witnessed daily the effects of poverty and unemployment on families, and on children in particular. In 1957, together with two other social activists, Sean Forde and Seamus MacEoin, she set up the Credit Union Extension Service, the role of which was to promote the credit union idea in Ireland. They were not alone in their quest, as other individuals and organisations in other parts of the country were also familiar with and were promoting the concept. Their efforts culminated in the foundation of the first credit union in Dublin in 1957. A momentum began to build as the strong support for credit unions from the deeply influential Catholic Church led to a rapid growth in the numbers of credit unions being established. The foundation of the Credit Union League of Ireland (now the Irish League of Credit Unions) in 1960 as an umbrella body for Irish credit unions, together with the enactment of credit union specific legislation in the RoI in 1966, contributed to the early and rapid growth of the sector.

Within 8 years of the first credit union being formed in Ireland, over 28,000 people had joined 100 credit unions. In 2015, 3.6 million people are members of over 525 credit unions throughout the island of Ireland.

There are three main credit union umbrella bodies in Ireland: the Irish League of Credit Unions (ILCU), representing 455 member credit unions in the Republic

[1] For detailed accounts of the origins and evolution of the co-operative credit and credit union movements in Ireland, see Power et al. (2011)

**Table 1** Breakdown of main statistics of Irish credit unions

| | Number of credit unions | Total assets | Total savings | Total lending | Total membership |
|---|---|---|---|---|---|
| Northern Ireland[a] | 161 | 1.39 billion pounds | 1.191 billion pounds | 0.517 billion pounds | 0.519 million |
| | | 1.96 billion euros | 1.68 billion euros | 0.73 billion euros | |
| Republic of Ireland[b] | 367 | 14.5 billion euros | 12.2 billion euros | 3.9 billion euros | 3.1 million |
| Total | 528 | 16.46 billion euros | 13.28 billion euros | 4.63 billion euros | 3.619 million |

[a]Bank of England Prudential Regulation Authority, as at December 2014, based on prudential returns made. Sterling figures are also shown in Euro using an exchange rate of £1/1.41 €
[b]Communication from the Registry of Credit Unions, June 2015, giving statistics as at March 2015 and based on prudential returns made

(359) and North of Ireland (96), the Credit Union Development Association (CUDA), representing ten member credit unions in the Republic (and with some overlapping membership with the ILCU) and the Ulster Federation of Credit Unions (UFCU), representing 46 credit unions in the North. In NI, there is also a small number of credit unions affiliated to the Tyrone Federation and others which remain independent. There are five additional independent credit unions in the RoI. Table 1 gives a breakdown of total assets, total savings, total lending and total membership of credit unions on the island of Ireland broken down by jurisdiction.

The ILCU is a credit union trade and representative body for credit unions, providing various business and support services for its members, including monitoring and supervision, training, marketing and advice on day to day operations. As already noted, its membership comprises credit unions throughout the island of Ireland. The seeds of the UFCU developed in the mid 1980s to support the development of credit unions in NI with 'a British identity',[2] with assistance from the National Federation of Credit Unions (NFCU) in England. The UFCU was formed in 1995 when these credit unions in NI broke away from the NFCU to form their own representative body. The UFCU provides various support services to its member credit unions and lobbies on their behalf. The CUDA represents a small number of large credit unions in the RoI, most of which broke away from the ILCU as a result of frustrations with the handling of a major IT project (ISIS[3]), representation of larger credit unions within the ILCU and the structuring of the Savings Protection Scheme (SPS[4]). The CUDA is a representative and development association for its member credit unions.

[2] *Source*: www.ufcu.co.uk

[3] Discussed later.

[4] Discussed later.

# 3 The Current Model

Credit unions in the RoI are primarily legislated for by the Credit Union Act, 1997 (as amended[5]) although provisions in other legislation, such as the Central Bank Reform Act 2010, the Central Bank and Credit Institutions (Resolution) Act 2011, and EU directives also apply to credit unions. They are regulated by the Registry of Credit Unions (RCU) within the Central Bank of Ireland. This position was effectively created in 2003 under the then Irish Financial Services Regulatory Authority (IFSRA) which itself was subsumed into the Central Bank in 2010. The functions of the RCU are to regulate, register and supervise credit unions with a view to ensuring the protection by each credit union of its members' funds and to maintain the financial stability and well-being of credit unions more generally.[6] In addition, the Credit Union Advisory Committee (CUAC) has a statutory role in advising the Minister for Finance on matters relating to credit union legislation. Significantly, the government established a Commission on Credit Unions on 31st May 2011 to conduct an in-depth review of the credit union movement in the RoI and to make recommendations on the structure, regulation and legislation of credit unions.[7]

NI credit unions are legislated for under the Credit Unions (Northern Ireland) Order 1985 (as amended) and by subordinate legislation. The Department of Enterprise, Trade and Investment (DETI) is responsible for the registration of credit unions. In August 2011, the Financial Services Authority (FSA) and HM Treasury published a joint consultation paper setting out proposals for the transfer of the regulation of NI credit unions from the DETI to the FSA. The stated aim was to enable credit unions in NI to offer a wider range of services than they were at the time permitted to do, and to extend the Financial Services Compensation Scheme and the Financial Ombudsman Service to NI credit unions, thereby protecting credit union members more fully. Since 31st March 2012 the responsibility for the regulation of credit unions is the responsibility of the Prudential Regulatory Authority (PRA) of the Bank of England and the Financial Conduct Authority (FCA).

## *3.1 Services*

The core services provided by credit unions are shares, deposits and loans. The rules governing the provision of these services differ between NI and the RoI. In NI, a member cannot have shares greater than STG£15,000 or 1.5 % of the total

[5] By the Credit Union and Co-operation with Overseas Regulators Act 2012 and various statutory instruments.

[6] *Source*: www.centralbank.ie

[7] Some of the Commission's findings and recommendations are discussed later in this chapter.

non-deferred shares in the credit union. In the RoI, these limits are greater and deposits are also permitted. Members can hold a maximum of 100,000 € in deposits. Total savings, including deposits and shares, must not exceed 200,000 € or 1 % of the total assets of the credit union, whichever is the greater. It should be noted that shares are non-tradable, meaning they are not quoted on the stock exchange.

Interest is paid on deposits, subject to the rate not exceeding the rate of return received by the credit union from employing the funds received. Dividends are paid on shares annually, where there is sufficient income to do so. In NI, the maximum dividend allowed is 8 % and in the RoI, this maximum is 10 % of the nominal value of shares. The average dividend paid by ILCU member credit unions in ROI in 2014 was 0.77 %. In NI, the average dividend paid in 2014 was 1.25 %. These figures have dropped considerably even since 2008, when the average dividend was 2.02 %. 14 % of credit unions did not pay a dividend in 2013 (ILCU 2014).

Lending in credit unions is also subject to various limits. In NI, the board of directors decides on the maximum loan that can be made to a member subject to the limits prescribed by the FSA. A Version 1 credit union[8] must not lend for a period of more than 5 years where unsecured and 10 years where secured. A Version 2 credit union must not lend for a period of more than 10 years where unsecured and 25 years where secured. In the RoI, the maximum loan that can be given is such that the total debt of the member to the credit union cannot exceed 39,000 € or 1.5 % of the total assets of the credit union. This is due to change by the enactment of regulation (expected by the end of 2015) to enable the Central Bank to stipulate the limits on the total, including percentage, amount of loans generally, or unsecured loans or class or classes of loans, that may be lent by credit unions. Currently, credit unions are permitted to give loans for periods in excess of 5 years to a total of 30 % of total gross loans outstanding if they meet certain regulatory liquidity[9] requirements (Central Bank 2010a). For example, a credit union, where between 20 and 25 % of lending exceeds 5 years, must have at least a 25 % liquidity ratio. A credit union where between 25 and 29 % of lending exceeds 5 years, must have a liquidity ratio above 25 %. If a credit union does not meet the liquidity requirements, lending in excess of 5 years cannot exceed 20 % of total gross loans outstanding. Credit unions must maintain a minimum liquidity ratio of not less than 20 %. Credit unions in Ireland are highly liquid with average liquidity levels of almost 42 %.

All credit unions have lending policies but there is a clear indication now that, due to increasing loan defaults, these policies are becoming stricter and greater evidence of members' income and expenditure (bank statements, credit card statements and so on) is being required to assess creditworthiness. Two thirds of credit unions in the ROI are members of the Irish Credit Bureau (ICB), a credit reference agency. The ILCU reported that loan write-offs in member credit unions in the ROI

[8] NI credit unions are considered to be Version 1 or Version 2 credit unions. Version 1 credit unions generally operate on a smaller scale and are more limited in their activities than Version 2 credit unions.

[9] Measured by liquid investments/uncommitted savings.

fell by 28 % in 2014 to 90 million euros which meant that loan write offs were lower than 100 million euros for the first time since 2009. Average loan arrears[10] were 16.1 % at December 2014, a figure which has fallen significantly in recent years as the economic recovery gains ground. Loan arrears peaked at 925 million euros in ILCU credit unions in the ROI in 2011, but loan arrears have fallen for 12 consecutive quarters since then. Total gross loan arrears stood at 573 million euros at December 2014. Provisions for bad and doubtful debts stood at 18.7 % at December 2014.[11] It should be noted that loan provisions in ILCU credit unions in the ROI now exceed total gross loan arrears (total gross arrears were 573 million euros by December 2014 with total loan provisions of 666 million euros, giving a buffer of 93 million euros). Credit unions may re-schedule loans, but regulatory requirements regarding re-scheduling were tightened in 2010 to prevent large scale re-scheduling during economic crisis. Re-scheduling is often viewed as a 'quick fix' which may hide an underlying problem with a loan or allow a credit union to mask its debt problems, potentially leading to much more substantial difficulties in the future. The level of rescheduling has dropped substantially since these regulatory requirements were introduced. In 2011, 2.39 % of loans were re-scheduled and this had dropped to 1.5 % by year end September 2014.

As a result of increasing bad debts, a majority of credit unions in the RoI face additional restrictions in their lending at present, restrictions which have been placed upon them by the RCU and the Central Bank. Four main restrictions are in operation: a limit on the total amount that can be loaned per month; or a limit on the total lending per member—some credit unions have a limit of 25,000 € in total that can be on loan to any one member (including any members who depend on the same source of income) while for others this figure is 10,000 €; or a limit on the loan duration; or finally, a limit based on the total loan repayments or a percentage of the total loan repayments received in that month. Credit unions have sharply criticised the imposition of these additional restrictions for several reasons. Firstly, the restrictions can inhibit the ability of credit unions to trade their way out of financial difficulty. Loan interest is the main source of income for most credit unions and a restriction on their ability to earn is seen as hindering their financial recovery. Secondly, for some credit unions, it results in rejecting loan applications from creditworthy members and for some members, may result in their resorting to other sources of credit. The concern here is that members will turn to moneylenders whose interest rates far exceed those of credit unions. Credit union managers and the media are reporting increasing resentment among members who have had reasonable loan applications rejected due to these restrictions. Thirdly, credit unions are frustrated by what they see as the lack of transparency in the decisions by the RCU and Central Bank to impose lending restrictions. However, since August 2013, credit unions may now appeal a regulatory direction to the Irish

[10] Calculated as gross loans which had not had a repayment for 10 weeks or more.

[11] There is further discussion of these figures later.

Financial Services Appeals Tribunal (IFSAT). There have been no known such appeals to date.

When compared to the banking sector as a whole in the RoI, credit union market share of household savings is in the region of 12.9 %[12] and about 34.5 % of consumer lending (excluding mortgages[13]). Between 2011 and 2013, savings in credit unions[14] decreased by 3 % and lending decreased by 27 %. Comparative figures for the banking sector (Central Bank 2011c, 2014a) show a decrease of 5 % and 37 % respectively, showing that credit unions are performing better than their banking counterparts. In 2014, the total assets of credit unions in the RoI represented approximately 2.7 % of the total assets of all domestic credit institutions.

The maximum rate of interest which can be charged on loans in both jurisdictions is 1 % per month on the reducing balance of the loan. This equates with an APR (annual percentage rate) of 12.67 %. In the RoI, credit unions are the only regulated financial institution for which there is cap on the interest rate that can be charged on loans.[15] The average rate of interest charged by ILCU-affiliated credit unions is 8.8 % APR (ILCU 2015). Some categories of loan have lower rates. For example, the average 'home improvement' loan interest rate is 7.25 % APR.

According to the ILCU (2010), among its member credit unions, 96 % of total lending is personal lending. Some credit unions also pay a loan interest refund (known as a rebate) to borrowing members from the operating surplus of the credit union. A refund of a percentage of loan interest can be given to borrowing members where a dividend has been paid to shareholders. The average loan interest refund paid in the ROI in 2014 was 9.55 % and in NI was 17.24 % (ILCU 2015). Some credit unions prefer to charge the full rate of loan interest allowable and to give a generous loan interest refund at the end of the financial year, as this is seen to reward members for making loan repayments. In an effort to encourage lending, more credit unions opt to pay a higher loan interest rebate rather than pay a higher dividend. Some 100 ILCU credit unions paid a higher loan interest rebate in 2014 than in 2013 (ILCU 2015).

Credit unions also give business loans, mostly to individuals. Some credit unions offer special interest rates on such loans. Given wide variations in practice and expertise among credit unions in the granting of business loans, the RCU in 2007 advised greater caution by credit unions in the RoI in the granting and monitoring of business loans (Financial Financial Regulator 2007). About 40 % of credit unions are now prohibited by the RCU from making any business loans as part of the additional restrictions discussed earlier.

Credit unions have in-built life savings and loan protection insurance. This means that in the event of a member's death, and subject to certain terms and

[12] Measured against total household savings taken from Central Bank (2014a).

[13] Mortgages are excluded because credit unions generally do not offer mortgages.

[14] ILCU affiliates.

[15] In fact, regulated moneylenders must charge a *minimum* of 23 %, and have no maximum limit.

conditions, members can have their outstanding loans cleared and next-of-kin can receive up to 100 % of their savings in a life insurance payment. Premiums for these insurances are paid as an operating expense of the credit union. Some credit unions also provide Death Benefit Insurance (DBI) as an extra service, whereby, in the event of a member's death, next-of-kin receive a payment to help pay for funeral expenses. Some credit unions pay the cost of the premium for this insurance as an operating expense, while others offer it as an optional service for which members pay directly.

Other services available from typical credit unions include money transfer, foreign currency exchange, home and car insurance and loan repayment protection insurance, all of which are offered by credit unions as agents of other companies. Credit unions also provide free debt counselling and financial advice, and work closely in association with the Money Advice and Budgeting Service (MABS), which is a publicly funded, free advice service for those experiencing problems with debt. Prior to the economic downturn, a very small number of credit unions offered mortgage facilities to members either directly or as a bank agent. Since the downturn in the economy, few, if any, credit unions continue to offer mortgage services.

Unlike the wider banking sector, a very limited number of credit unions offer debit card and prepaid card services and ATMs (cash dispensers). In fact, one of the main drawbacks which has been facing Irish credit unions in developing their range of services has been their limited technological capability. Because credit unions are autonomous, there has been limited co-ordination between them in respect of many aspects of their operations. This is due primarily to the fact that credit unions are not linked together through IT systems. Each credit union operates its own system. While this is beneficial in some respects, it also causes unnecessary duplication in function and expense. In the late 1990s, there were as many as 33 different IT operating systems in the credit union movement, each carrying its own maintenance and development costs. Few, if any, of the IT systems could integrate with one another in whole or in part. The ILCU initiated the 'ISIS project' to create a centralised banking system for all credit unions and which would be owned and managed by them. Following enormous overruns in the estimated costs of the system and weak project management, the project was abandoned. Untold damage was done to the confidence of credit unions and of the RCU in the ability of credit unions to introduce a central IT system. Another consequence was a split in the movement as the larger credit unions moved away from the ILCU and formed CUDA, as discussed above. There are now a reported 11 IT providers servicing the credit union movement.

### *3.2 Membership*

Credit unions in Ireland operate under a common bond system. The common bond is normally defined in three ways: by residence, that is, members working or living in a certain geographical area; by occupation, that is, members who are police officers, teachers, civil servants; and by employer, such as members employed by the postal services, telephone company etc. In very broad terms, credit unions defined by geographical area are referred to as 'community credit unions' and those defined by occupation or employer are referred to as 'industrial' credit unions. About 10 % of Irish credit unions fit the 'industrial' description while the remaining 90 % are organised as 'community' credit unions.

The common bond is the sense of shared belonging and collective interest (FSA 2003) intended to help credit unions to "*circumvent the problems of imperfect information*" (Interim Report of the Credit Union Commission 2011: 17). In other words, it is designed to help credit unions to know who their members are, thereby reducing lending risk and increasing the incentive to save.

Credit unions are permitted to recruit members who hold the common bond of the credit union and can only provide services to existing members. Where a member ceases to hold the common bond of the credit union of which they are a member, the member can retain membership and voting rights. In the RoI, loans outstanding to members who cease to hold the common bond cannot exceed 10 % of total outstanding loans. There is no such stipulation for NI credit unions but members who no longer hold the common bond, referred to as non-qualifying members, cannot exceed 10 % of the total membership.

For some credit unions, the existence of a common bond restricts further growth, particularly where the potential membership of the existing common bond has been saturated. And because Ireland has so many credit unions geographically speaking, there are scarcely any members of the population who are not served or potentially served. Credit unions have adopted a number of approaches in revising and redefining their common bonds in order to sustain membership growth. For example, some industrial credit unions, where recruitment of employees by the companies being served under the common bond has ceased or been restricted, have widened their common bonds to include membership by employees of additional companies providing similar products or services, and to family members. Some community credit unions have taken the approach of extending their common bond to include all 'non-qualifying' members at a certain point in time or to include new housing estates on the margins of the existing common bond. Clearly, this approach to redefining common bonds is not sustainable in the medium to long term in preserving growth in membership where common bonds are already saturated. If credit unions wish to continue to grow in membership size, they must, where possible, identify and target non-members who hold the common bond. About one half of the population have yet to join a credit union, so enormous potential remains to grow the membership of the movement. This most certainly will mean targeting younger generations of members. Because of the limitations of the common bond, credit unions can focus their member recruitment efforts on their potential membership with relative ease. However, given that each credit union has to do its own recruitment, within its own individual budget constraints, this can be expensive. For the past 6 years, the ILCU has run a national advertising campaign, funded collectively by contributions from individual credit unions, to attract new members. The emphasis of the advertising is on the safety, security and flexibility of credit unions and their local, friendly approach to providing financial services.

The only other realistic option for credit unions to grow their membership is to merge with neighbouring credit unions, an issue discussed later in this chapter. There are some who would state that the common bond concept is outdated and, apart from restricting growth, also discourages competition between credit unions and should be relaxed as it has been in other countries, such as the US and UK. The Commission on Credit Unions, in its terms of reference, was asked to consider the "*function of the common bond in the context of modern financial services systems*" which suggested that the current common bond model needed to be modernised in some way. The Commission recommended that no change be made, stating that, "*the common bond is a fundamental characteristic of credit unions and the Commission envisages that credit union members will continue to have a strong sense of belonging to their credit union*" (2012: 87). However, it did note that there is scope for closer co-operation and co-ordination among credit unions towards shared services.

## *3.3 Organisational Structure and Governance*

Each credit union is entirely autonomous. This means that each credit union's finances and operations are completely independent of any other credit union or other body. There are inherent advantages and disadvantages in this organisational approach. The advantages include a clear sense of ownership and control of local entities by local members and protection of individual credit unions from any potential poor financial management in other credit unions. The disadvantages can include an inability to achieve efficiencies due to the often unnecessary replication of functions and processes across a large number of similar entities. These are issues to which we will return in the discussion of rationalisation later.

Figure 1 demonstrates the structure of a typical credit union. As with other co-operatives, credit unions are owned and controlled by their members. The members elect a board of directors to represent them. Boards must be comprised of an uneven number of members between 7 and 11 (RoI) and between 5 and 15 (NI). Boards have responsibility for the general control, direction and management of the affairs, funds and records of the credit union. Board members are elected at the annual general meeting of the credit union and receive no remuneration for fulfilling their duties. The members also elect, from among themselves, a supervisory (NI)/board oversight (RoI) committee, comprising of three or five members (RoI) or not less than three and not more than seven members (NI), whose role it is to oversee the performance of their functions by the board. This is much like what is termed an 'audit committee' in more conventional organisations, but the key difference is seen in the total independence in credit unions of the supervisory/board oversight committee from the board. The committee members receive no remuneration for their duties. The Commission recommended the

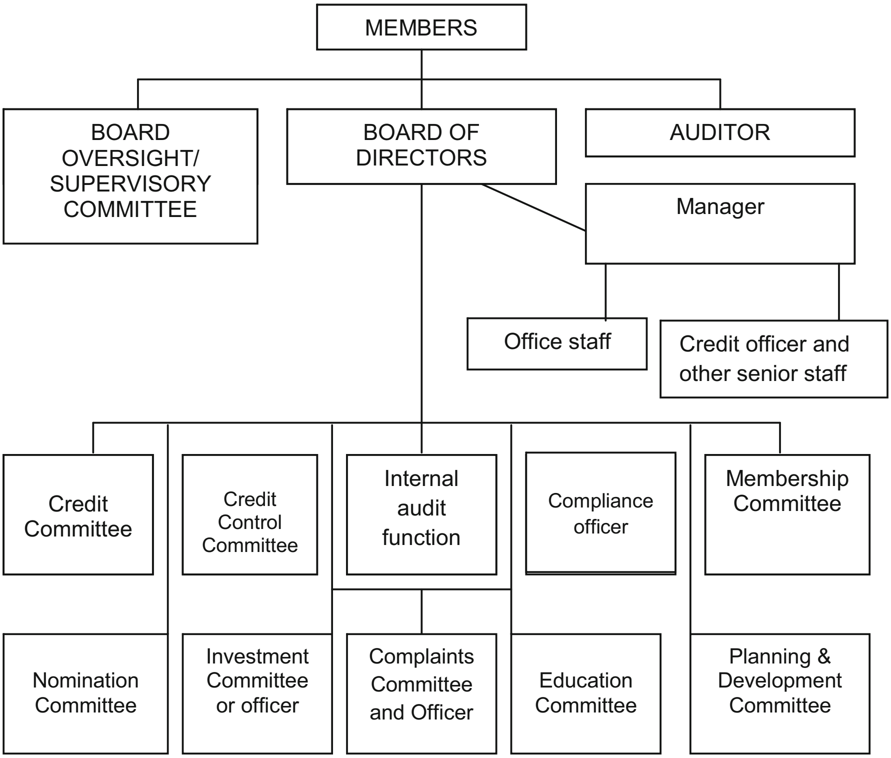


**Fig. 1** Structure of a typical credit union

establishment of an additional internal audit function to provide for the evaluation of the effectiveness of the credit union's risk management, internal controls and governance processes (2012: 158) "*in light of the ever-growing complexity and technical detail facing credit unions in their day to day operations*" (2011: 58). The members also elect an external financial auditor to audit the annual accounts. The board of directors appoints a CEO or manager to oversee the day to day operations of the credit union who, in turn, may appoint other office staff members.

There is also a sub-committee structure in credit unions which fulfils various functions, including the approval of loans (credit committee), pursuing members in debt (credit control committee), approval of new members (membership committee), nomination of members to serve on the board and committees (nominating (NI)/nomination (RoI) committee), and so on.

Various problems with the organisational and governance structure of Irish credit unions have been apparent, such as dominant individuals, gender imbalances, lack of youth involvement, very poor attendance at AGMs, lack of relevant training and education of the board and supervisors, volunteer burnout, unrepresentative boards, failure to hold proper elections, and so on [see for example, Byrne (2006), McKillop et al. (2002, 2006), McCarthy (2005), Byrne et al. (2002, 2004)]. Many of these relate to difficulties around the participation of members in the governance of the organisation. Credit union ethos strongly urges members to become actively involved in what Briscoe and Ward (2005) refer to as the *design for use* of their credit union—giving feedback, participating in the AGM, volunteering their services for positions on the board and sub-committees and so on. Education is also seen as fundamental in giving members the skills and knowledge they need to be effective and informed participants in their organisation.

Governance weaknesses have not gone unnoticed within the sector. Indeed, the RCU in the RoI issued a guidance note to credit unions in May 2005 on the control, direction and management of credit unions, reminding boards and key committees of their duties and highlighting good practice regarding elections (Financial Financial Regulator 2005). Various educational and training courses have been put in place through the representative bodies and universities in particular. Indeed, the Central Bank (2014b :5–6) stated it was "*concerned about the fundamental weaknesses [it] identified in governance, lending, operations and risk management*", highlighting that credit unions had not addressed "*the scale and scope of governance, risk and operational management changes required under the strengthened regulatory framework*". With the near collapse of the banking system in Ireland, new fitness and probity requirements have been introduced by the Central Bank of Ireland under the Central Bank Reform Act 2010. Under a new Fitness and Probity Standards Code (Central Bank 2011a: 7), persons are required to be "*competent and capable; honest, ethical and to act with integrity; and financially sound*". The new Fitness and Probity regime for credit unions came into effect on 1st August 2013 and is expected to be fully implemented by 1st August 2016. The Central Bank (2011b) has also set out revised minimum competency requirements for all those providing retail financial products. While this also applies to credit unions, The Commission recommended that consideration be given to developing a wider minimum competency code for credit unions following implementation of the governance requirements and fitness and probity regime (2012: 165).

As mentioned above, all credit unions in Ireland are autonomous units and most affiliate to a central umbrella body. By and large, the umbrella bodies act as representative organisations. They do not provide central banking services for credit unions, although the development of some central services for credit unions has been ongoing, as discussed earlier. The ILCU has also put a regional structure in place. This takes the form of 25 'Chapters' organised on a geographic basis, comprising what are essentially clusters of credit unions. Chapters have no powers and are designed as a means to share information between credit unions in similar geographic areas. Chapters are supported by credit unions to varying degrees and there have been numerous failed attempts to re-structure the Chapter system. Credit unions normally meet as a body once a year at the annual general meeting (AGM) of their representative body. The AGM is a forum to discuss issues affecting credit unions and to decide on major policies, vote on various motions and elect a representative board. Each credit union carries two votes at the AGM of the ILCU, regardless of the size of the credit union.

There is also a number of ‘interest’ groups among credit unions. The Credit Union Managers’ Association (CUMA) was set up by credit union managers as a professional resource organisation. It has no powers per se and acts to represent the interests of managers and of credit unions in general. The National Supervisors’ Forum (NSF) was established by supervisory committee members in credit unions to provide support and information for supervisors. IT users’ groups have also been established among credit unions using the same IT platforms.

Despite the existence of various groupings within the credit union movement, there has been very little rationalisation among credit unions through the establishment of shared services, networks or collaboration. Later, this chapter examines more recent moves towards greater rationalisation in the movement.

## *3.4 Financial Structure and Performance*[16]

Credit unions’ main sources of income are loan interest and returns on investments. In general terms, credit unions have traditionally invested surplus funds, that is, funds which are not lent to members, in deposit accounts, government bonds, bank bonds, equities and collective investment schemes. Loan interest, giving an average return in the RoI in 2013 of 8.8 %, is considerably higher than investment income, which gave an average return of 3.1 % in the ROI in 2013. It is clear that investment returns are falling and that this average return of 3.1 % recorded in 2013 will not be maintained as most credit union investments are in bank deposits and banks are cutting margins. Therefore, at least in theory, credit unions need to maximise lending in order to maximise income. This, of course, assumes that borrowers repay their loans in full and on time. Credit union surplus (profit) is defined as the excess of income over expenditure. Expenditure includes insurance, salaries, office expenses, bad debts and investment write-downs. Unlike the profits of banks in Ireland, credit union surpluses are not subject to corporation tax. Investment write-downs, caused by the collapse in the financial markets, reached a high of 73 million euros in 2008. This impacted heavily on the operating surpluses of credit unions and hindered their ability to pay dividends on shares. Credit unions allocate their surplus as a dividend on shares, and in some cases as a loan interest rebate, only after reserves are set aside. They are required to ensure that the statutory reserve is at least 10 % of total savings. In addition, under the Regulatory Reserve Ratio (RRR), credit unions in the RoI must ensure that total reserves as a percentage of total assets are at least 10 %. Finally, credit unions in the RoI must also maintain a Minimum Reserve Requirement of 1 % of savings with the Central Bank. Most credit unions also allocate to a general reserve or to a specific reserve for future use.

[16] For a comprehensive analysis of the financial performance of Irish credit unions, see McKillop et al. (2006) and the Report of the Commission on Credit Unions (2012). The data presented in this section is taken from the ILCU Annual Report (2014).

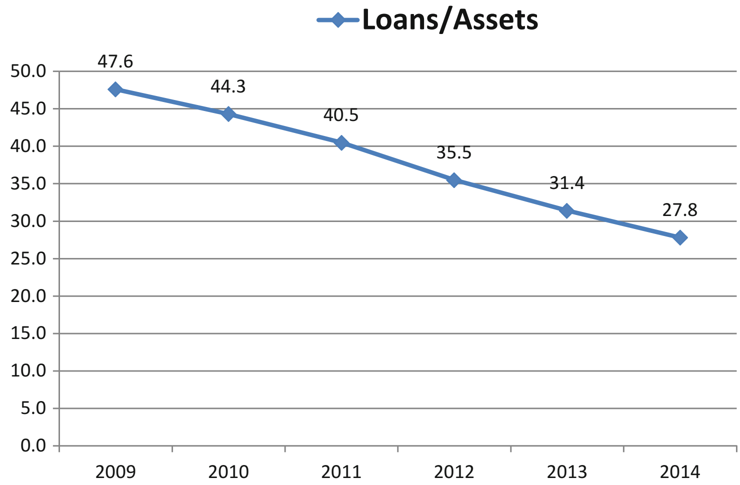


**Fig. 2** Loan/assets

Each credit union is required to make a prudential return of key financial information. This section presents some of the key financial ratios of Irish credit unions for 2009–2014 based on the returns made to the ILCU. Detailed figures are not available for non-ILCU credit unions but given that the ILCU represents over 85 % of all credit unions, these figures can be taken as indicative of the overall financial situation in Irish credit unions. An analysis of the prudential returns is conducted by the ILCU using the 'PEARLS[17] ratios'. These are a set of ratios used to monitor the financial performance of and financial trends in credit unions. An analysis of the ratios shows increasing pressure on credit union finances, as lending and investment income are declining, and operating costs and loan arrears are increasing. On the other hand, reserves, liquidity and solvency are strong so the longer term outlook is reasonably positive. A selection of these ratios is presented here.

Figure 2 shows lending as a percentage of total assets. Total lending is in decline and, at December 2014, stood at 27.8 % of total assets. The PEARLS ratios norms recommend that credit union lending should exceed 70 % of total assets. At December 2014, total investments as a percentage of total assets were 71.4 %, while PEARLS ratios recommend that investments should not exceed 30 %. Given that loan interest is far higher than the return on investments, this is impacting negatively on credit union income. On the other hand, decreased lending may also protect credit unions from increasing bad debts, although it raises questions about the core business of credit unions.

[17] The PEARLS monitoring system was devised by the World Council of Credit Unions. The ratios are Protection, Effective financial structure, Asset quality, Rates of return, Liquidity, and Signs of growth.

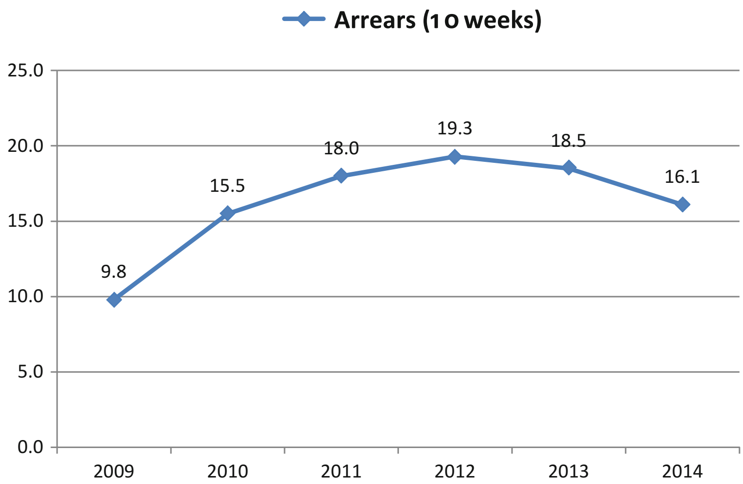


**Fig. 3** Loan arrears (10 weeks or more)

Figure 3 demonstrates that loan arrears doubled between 2009 and 2013, from 9.8 to 18.5 %, but this figure is now in decline. Loans written-off for the full year to September 2014 stood at 2.5 % of total loans, while 1.5 % of total loans were re-scheduled.

Figure 4 shows that the capital of credit unions as a percentage of total assets is growing. This reflects the increased reserve requirements of the RCU and shows credit unions to be in a healthy condition from a capital point of view. ILCU credit unions in the RoI have 709 million euros in surplus capital (reserves).

Figure 5 shows the average solvency ratios. These have remained reasonably stable, currently standing at 121 %, well in excess of the recommended 109 %.

Liquidity in credit unions, as shown in Fig. 6, has grown considerably since 2009. Credit unions have put an emphasis on increasing their liquidity and given that short-term deposits now offer relatively high rates of return, credit unions have grown their liquid investments.

### *3.5 Stabilisation and Compensation*[18]

In 1989, the ILCU put a Savings Protection Scheme (SPS) in place to protect the savings of its members in the event of credit union insolvency. All ILCU-affiliated credit unions must contribute to the scheme as a condition of affiliation. The SPS is

[18] For a more detailed discussion of existing and suggested stabilisation arrangements in Irish credit unions, see for example, Central Bank and Financial Services Authority of Ireland (2010b), Spotlight (2011) and the Commission on Credit Unions (2011).

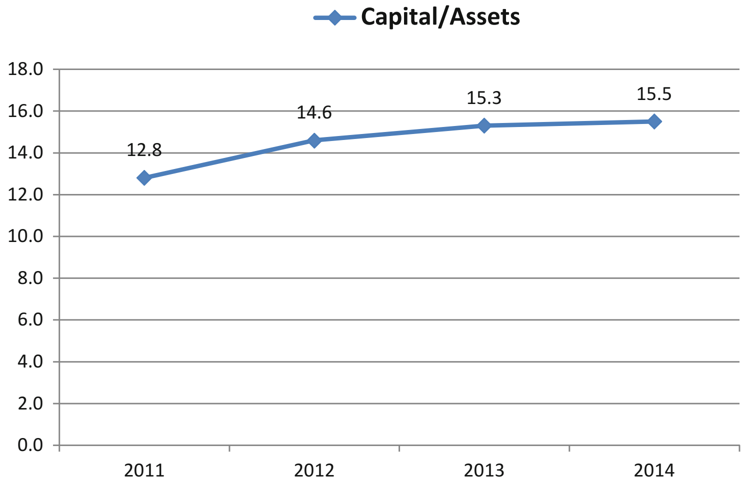


**Fig. 4** Capital/total assets

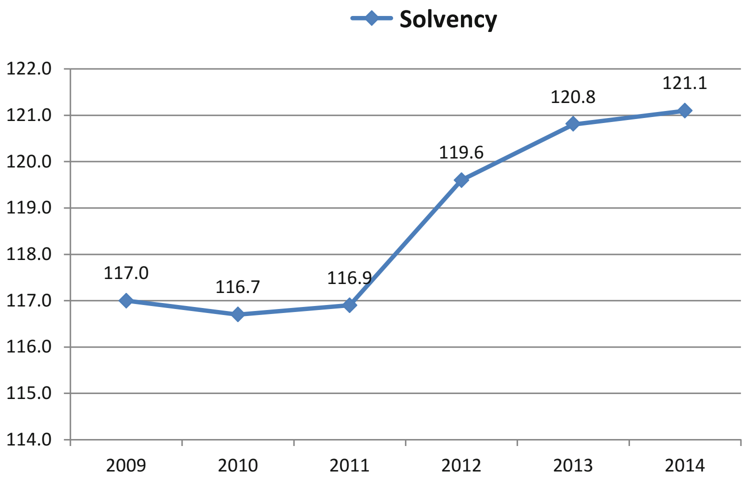


**Fig. 5** Solvency

a non-statutory fund controlled by the ILCU. The SPS can help credit unions to trade out of difficulty (stabilisation). It can also compensate individual credit union members up to a maximum of 12,700 €/STG£10,000 (compensation), although this has never been necessary. In more recent years, the SPS has been the subject of much controversy for a range of reasons. These are summarised by the Central Bank (2010b: 2): "*there are questions about governance and accountability arrangements, which reflect the fact that it is a discretionary arrangement operated by the board of the ILCU, and is not a scheme open to all credit unions. This*

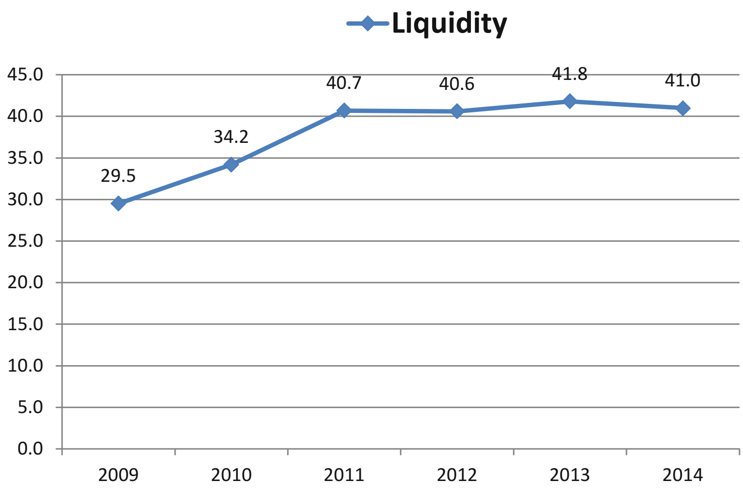


**Fig. 6** Liquidity

*discretion inevitably introduces uncertainty about the circumstances when the SPS could be utilised*." As the number of credit unions facing difficulty increases, the value of the fund has been reducing.[19] If there were larger scale problems in credit unions, there is a fear that the SPS would not be sufficient to assist credit unions and their members. The Central Bank in the RoI does not approve of the SPS due to "*its operational platform, governance issues and lack of consensus within the movement about the scheme*" (Central Bank 2010b: 6). Addressing this issue is quite complex, not least because the fund is owned by credit unions in two different jurisdictions. Furthermore, in September 2008, credit unions in the RoI were included in the Statutory Deposit Guarantee Scheme (DGS) under which 100 % of individual members' savings have guaranteed protection up to a maximum of 100,000 €. Since then, "*the purpose and relevance of the current SPS is in doubt*" (Central Bank 2010b: 2). In 2010, the Central Bank issued a consultation paper on stabilisation support for credit unions, presenting a number of possible stabilisation models. It would appear that the Central Bank favours an external stabilisation solvency support mechanism to give short term, time limited support to credit unions in difficulty. This presumably means that credit unions facing longer term difficulties would be wound up by the Central Bank. The Commission recommended the establishment of a statutory stabilisation scheme to be funded by mandatory contributions by credit unions. The legislative basis for stabilisation is now contained in the Credit Union and Co-operation with Overseas Regulators Act 2012 (the 2012 Act). The Act enables the Minister for Finance to provide stabilisation support from what has been termed 'the Credit Union Fund'.

[19] It decreased from 119 million euros in 2009 to 96 million euros by the end of 2014.

The Central Bank and Credit Institutions (Resolution) Act 2011 enables the Central Bank to intervene swiftly where a credit union is experiencing difficulties with stability. It gives the Central Bank powers to order a transfer of engagements by one credit union to a willing transferee and to appoint a special manager to a credit union in distress for a period of up to 6 months. The government transferred 250 million euros to a 'Credit Institutions Resolution Fund' to fund resolution of credit unions in difficulty. There have been four cases of credit unions in difficulty since 2012 where the Central Bank has intervened. The first of these credit unions, following the appointment of a special manager, had its assets and operations transferred to a bank. Two cases involved credit unions which were forced to merge with another, while the fourth was liquidated.

### *3.6 Moves Towards Rationalisation*

In 2002, the ILCU began to discuss the need for rationalisation in the credit union movement. A range of driving forces for rationalisation were beginning to appear (Byrne 2006): tightening margins, increasing loan defaults, decreasing market share for loans, declining growth rates, very weak liquidity some credit unions; limited technological capacity and fragmented IT systems, limited product range, restrictive legislation, weak governance, and ultimately a potential for credit union failure. All of these issues were seen as key driving forces for credit union rationalisation in other countries, including the US, Canada, Australia and New Zealand. In 2004, the ILCU set up a Rationalisation Committee to explore the options available to credit unions to strengthen their business model through rationalisation. Three options were presented to credit unions in the final report: do nothing, which was seen as not sustainable; amalgamations/mergers (legislated for as 'transfers of engagement'), which was seen as not always being desirable; or the development of strategic alliances, networks, credit unions service organisations and federated models, complemented by some amalgamations where necessary, which was seen as the most viable approach (Byrne 2006).

While there was much discussion within the credit union movement on the options available, little systematic progress on rationalising the movement occurred. Since 2006, many of the conditions which were seen to be driving rationalisation have deteriorated, not least because of the economic recession in Ireland. Detailed analysis of the financial situation of credit unions in the RoI is presented in the Commission on Credit Unions (2011) showing credit union income to be in decline, having decreased by 2 % since 2006 overall, but with a very sharp decline of 9 % between 2009 and 2010. The decline in income is being experienced by credit unions of all sizes. Operating costs have doubled since 2006. The dramatic increase in costs is a result of increasing bad debts provisions, loans written off and investment losses, already discussed above. There have been 60 transfers of engagements of ILCU-affiliated credit unions since 2006 (55 in the RoI and 5 in NI). All of these involved the transfer of a relatively weak credit union to a relatively strong credit union. More strategic transfers, where relatively strong credit unions merge with similarly strong credit unions, have not occurred to date. This reflects experience in other countries where the elimination of the weakest credit unions took place first before strategic mergers began. Since 2009, the RCU has been actively encouraging credit unions to consider merging, particularly where significant financial or governance problems exist. Under the EU/IMF Programme of Financial Support for Ireland (2011: 9–10), the Irish government has committed to obtaining "*the necessary powers to promote a higher degree of consolidation in the sector through mergers, where appropriate, with government financial support if warranted*". The ILCU provides information and assistance to member credit unions seeking to merge. Following a recommendation of the Commission on Credit Unions, a Credit Union Restructuring Board, known as 'ReBo' was established on 1st January 2013 in accordance with the 2012 Actas the "statutory body responsible for facilitating and overseeing the restructuring of credit unions to support their financial stability and long term sustainability".[20] To date, approximately 110 credit unions are said to be engaging with the ReBo.

Apart from the work of the ReBo, a number of credit unions have been forming strategic alliances. One formal strategic alliance of credit unions has been formed in the south west of Ireland, comprising seven credit unions. It is a registered co-operative and, while it is in its early stages, it employs a project manager, a solicitor and a credit control officer. Another is the Unity Co-operative Society Limited, a shared services company run by and for seven credit unions in the South West Dublin area. In 2010, the ILCU also formed a Credit Union Services Organisation known as 'CUSOP'. CUSOP (Payments) Limited is a payment institution authorised and regulated by the Central Bank. It provides a single payment platform for participating credit unions enabling them to provide electronic payment services to their members. This is now live with 68 credit unions processing payments. CUDA has also established a shared IT platform for its member credit unions.

## 4 Future Outlook for the Irish Credit Union Movement

The credit union sector in Ireland has been under intense scrutiny since 2010 and the way in which credit unions operate and the extent to which they are regulated has changed dramatically since then. In NI, regulation of credit unions has transferred to the PRA and the FCA in the UK. This effectively creates a two-tiered credit union movement. 'Version 1' credit unions will still be quite restricted in the services they offer, including a limit on lending to any individual of a maximum of STG£15,000 in excess of the attached shares held by that member. 'Version 2' credit unions will have far greater scope than heretofore, albeit operating with higher minimum prudential requirements and more detailed procedures and

[20] www.rebo.ie

controls (FSA 2012). Potentially, it will mean that some credit unions in NI will be able to expand their services significantly.

In the RoI, the focus is on greater consolidation of the sector. An independent strategic review of the sector was conducted at the request of the Irish government's Minister for Finance in 2010, followed by regulatory stress testing in early 2011. Following a change in government in March 2011, a Commission on Credit Unions, inclusive of key representatives of the credit union sector, was appointed to make recommendations to strengthen the regulatory framework and to provide for more effective governance of the sector. The government has commitments under the EU/IMF programme of support to consolidate the sector and has committed funds of up to 1 billion euros aside to re-capitalise credit unions if necessary. The recommendations of the Commission on Credit Unions informed the preparation of credit union legislation which was published in July 2012 and made various recommendations regarding the strengthening of the regulatory framework for credit unions including more effective governance and regulatory requirements.

According to the Commission, significant financial problems were apparent in up to 50 or so credit unions. Collectively, credit unions are facing increased bad debts and arrears, decreased lending and tight cost/income margins. At the same time, they have been increasing their reserves and the majority of credit unions remain solvent. It is clear that there will be more mergers, particularly of weaker credit unions with stronger credit unions. What is not so clear is how credit unions will protect and build upon their unique voluntary, not-for-profit, member orientation. Increasing regulation needs to be balanced with enabling credit unions to continue to serve the borrowing and saving needs of the members. The member is at the heart of the co-operative idea and a co-operative that does not or is unable to meet the needs of its members does not survive for long. Credit unions are seen as critical in their local areas and they enjoy widespread political and community support. It is hoped that the results of consolidation in the sector will be a stronger, more resilient credit union movement that can survive to serve its local member needs in the long-run.

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