**The Gold Medal for Best Letter Submission 2014**

# AN ANALYSIS OF THE NEWBRIDGE CREDIT UNION TAKEOVER: WHAT COMES NEXT FOR IRELAND'S CREDIT UNIONS?

**Keith Winters***

Dear Editor,

Given the recent spate of coverage in national and local media regarding the Irish credit union sector, and having worked in a legal and risk capacity with a credit union over the past year, I thought it might be useful to relay some of my own reflections on the issues facing a movement that has become so deep-rooted in the Irish psyche.

On the evening of the 10th of November 2013 the High Court, in dramatic fashion befitting the prospect of a 'run' on deposits at a financial institution, convened a late night sitting which ultimately resulted in the Court giving its approval of an application by the Central Bank to use its powers under the Central Bank and Credit Institutions (Resolution) Act 2011 in directing the transfer of the assets of Newbridge Credit Union Ltd. (NCU) to Permanent TSB.

This is the first time that a credit union has been taken over by a bank in Ireland and while the precedent is theoretically a worrying one for those within the Irish Credit Union movement it is unlikely to be replicated across the sector. NCU presented the Central Bank with a particular set of problems whose scale is not mirrored to the same degree among the one-hundred or so credit unions (of 392) that have been identified as requiring closer supervisory scrutiny. For other credit unions in trouble it is unlikely that a course of action as severe as has been taken with NCU will be necessary with the voluntary transfer of engagements into more stable anchor credit unions being the preferred route. The political repercussions of the NCU transfer will

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be unknown until the depth of the problems within credit unions are addressed in the context of the new regulatory arrangements.

The legal issues that have arisen as a result of the meteoric rise and fall of NCU are beyond the scope of this letter, and are in any event too raw and fresh to be adequately analysed at this time. Whether NCU's failure was imminent and whether such a failure would have spread contagion across the credit union sector and the wider financial services sector is a matter of debate, but the Court was convinced by the Central Bank's speculation in making its decision, a decision which seems to be rooted primarily in political considerations resulting from Ireland's imminent departure from the EU/IMF bailout programme.

Notwithstanding the legal issues at play, the NCU story is itself a microcosm of the now jading and oft-told tale of the Irish financial institution that outperformed its peers, grew exponentially and ultimately lost the run of itself during the Celtic Tiger years, before coming crashing down to earth following the disappearance of a make-believe economy built solely on the sandy foundations of an overheated property market. The principal difference here though, is that NCU, as a credit union subscribed to an ethos at variance with that of the for-profit banking sector, and because of that ethos its difficulties should never have reached the point where a bailout of such magnitude was required.

One of the contributing factors to NCU's demise rests undoubtedly in a huge governance failing on the part of the credit union as detailed in the High Court by the affidavit of the Head of Resolution at the Central Bank, and while the problems in NCU may have been amplified compared with its peers, the standards of governance within credit unions have and still vary considerably from institution to institution. It cannot be denied that there was also a significant failure in the regulation of the sector, which persisted up until the commencement of the bulk of Credit Union and Co-operation with Overseas Regulators Act 2012 (CUCORA) in October 2013. In the years when the seeds of instability were sown in the sector the Financial Regulator failed to adequately reign-in delinquent boards of directors, which stemmed from a combination of light-touch regulation and the fact that the Regulator's powers of enforcement and sanction were virtually non-existent.

This failure to effectively regulate credit unions allowed them an environment where it was acceptable for them to move away from their traditional community-based, small lending model and flirt with commercial lending practices more at home in the banking sector than a member-owned and member-run not-for-profit organisation. Equally, some credit unions were so flush with cash that their investment strategies began to elevate return-on-investment over risk, which had some devastating consequences, most notably for those credit unions who were unlucky enough to stay the course with custom-made bonds sold by Anglo Irish Bank, which was, incidentally, an A-rated bank at the time. Peculiarly credit unions became, and remain, the only Anglo bondholders to have been 'burned'.

Of course not all credit unions got involved in reckless lending practices, nor did all credit unions make risky investments, but it does seem to have been far more common than is widely believed. Unfortunately, this loose control of credit unions often led to the availability of cheap and easy credit as well as the delivery of a generous dividend on members' shares each winter. Happy members were understandably acquiescent to such loose practices and tended not to question the governance arrangements or underwriting surrounding the extension of credit and dividends. As a result lots of credit unions overextended their loanbooks and neglected their capital positions. Once we hit the late 2000's the global financial meltdown contagion spread and the Irish property market shuddered to a halt; people were quickly out of jobs, arrears mounted, consumption decreased, loan-demand dissipated, investments crashed, and the poor governance structures within credit unions made it difficult for them to respond to the series of systemic-shocks effectively, thus compounding their many problems.

In the wake of such a lax approach to governance within some credit unions and such poor supervision of them, an assertive approach to resolving the issues within the sector is essential in ensuring that there remains a strong and viable movement within Ireland. Many of the problems that exist within the sector today stem from inadequate supervision of these organisations run voluntarily, and they could and should have been avoided by better regulation with an effective enforcement regime. Unfortunately what we have now with the coming into force of CUCORA is a more complex and disjointed regulatory regime, introduced nearly all at once and applied with near-universally with a severe lack of clarity to a sector used to what must have seemed like self-regulation.

The new regulatory framework has the right goal - that of bringing credit unions into line with the standards of governance expected of institutions of their size - but the end does not justify the means, unless of course, there is a genuine desire on the part of the Central Bank to see the sector being put under so much pressure that its very existence is jeopardised. Falling loan-books and increasing arrears across the sector are being stressed further by an expected drop in investment income for credit unions as a result of their reclassification under Basel III, and that's before credit unions even begin to realise the unfavourable effects of being unsecured lenders under the new personal insolvency regime.

Following the final Report of the Commission on Credit Unions, published in the Spring of 2012, the Government published the Credit Union Bill 2012 which was enacted as CUCORA. This piece of legislation has introduced sweeping changes to the governance arrangements within Irish credit unions and aims to provide for the professionalisation of credit union management while at the same time refocusing directors' energies on mapping out the strategic direction and vision for their institutions.

These changes of focus are underpinned by new fitness and probity standards for staff and volunteers introduced under the Central Bank (Reform) Act 2010 as well as a requirement under CUCORA for credit unions to appoint a manager, compliance officer, risk management officer, internal audit function as well as having in place a strategic plan. The distinction is definitively made between the day-to-day management, or executive function of the credit union, and the governance function as exercised on behalf of the members by the board of directors, which should ensure that the day of volunteers being involved in the minutiae of how the credit union office functions, is gone.

The rules on who can do what within the credit union have also been tightened with more of an emphasis on a separation of duties. All these things make absolute sense but the approach to implementation is unrealistic at best and reckless at worst. All of these requirements are already obligatory for credit unions (with the exception of those with total assets below €10million) and are causing huge strains on boards and management who fear the prospect of the Registrar of Credit Unions making use of her new enforcement powers. The Commission Report spoke at length about a tiered approach to regulation; alas it never materialised in CUCORA and credit unions are suffering as a result.

In addition to the aforementioned internal requirements CUCORA introduced the Credit Union Restructuring Board, or ReBo, which has been established to facilitate the voluntary restructuring of the sector. Sharon Donnery, the Registrar of Credit Unions, has made it quite clear that she has no agenda in consolidating the sector, but rather, that her mandate as a regulator is to implement the Commission's proposals using the regulatory machinery now available to her. From the point of view of good regulation a consolidated credit union sector with less but larger credit unions will certainly be easier to supervise, and it should be easier to ensure that those involved in the running of credit unions meet the necessary standards as the movement recovers, grows and consolidates.

Credit Unions accept the need for better regulation but argue that this could be achieved with a more even handed approach, and I have to say I agree. Fortunately from what I have seen, Ms. Donnery seems like she will have a common sense approach to enforcement, but the law is the law and credit unions are going to find compliance a huge issue. While this will mean changes for Credit Unions as we know them, for the many law students among COLR's readers, it may well create an alternative future career path.

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Keith Winters