



FINANCIAL REGULATOR
Rialtóir Airgeadais

The National Supervisors Forum

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Address by Brendan F Logue

Registrar of Credit Unions

Mr. Chairman, Delegates,

My presence here today is an unexpected pleasure for me as many of you will already be aware that I was scheduled to retire from the position of Registrar of Credit Unions in September. Fate in her wisdom has decided otherwise, so here I am again. However, I definitely promise that this is the last time you will have to listen to me.

The Financial Environment

It would be stating the obvious to say that, even since last year, the economic, financial and social world has changed dramatically. Rising unemployment, the collapse on property prices and the uncertainty about the provisions of the upcoming budget have all contributed to an unprecedented degree of uncertainty in all parts of society and the credit union movement is no exception to this. It is therefore important that supervisors and their boards recognise that what has happened is unprecedented and that they react accordingly in the discharge of their duties. Now is a time when the importance of supervisors to

the credit union movement will have to come into sharp focus. It is also a time of challenge for supervisors. This challenge must be met by supervisors or risk being seen as irrelevant to the movement. I have some very direct things to say about the way supervisory committees operate and report to their members which I hope will start people thinking about how they do business, but more of that later. Suffice it to say that I am calling for a radical rethink by supervisors about how they discharge their roles.

What should happen

When a storm is raging it is necessary to get all hands on deck and batten down the hatches. This now applies to the directors and supervisors of credit unions. I regret to have to say that many supervisory committees are still below decks oblivious of the storm now raging. This is also a time for discipline and unity of purpose as between directors and supervisors. A hard headed approach to the business of the credit union is now needed. Anything less will threaten its survival. The traditional service ethos of the movement will become ever more important to members but its operation will need to be tempered by sound common sense when deploying the funds which have been entrusted to credit unions by their member/savers. Decisions on lending and investing must be driven by cold logic rather than by emotion, however well intentioned. All facts should be assiduously checked before any decisions in these areas are made and supervisors need to verify that directors are doing this. The idea that supervisors can in some way be treated like apprentice directors, must end. The negative reaction of some boards to honestly expressed concerns by their supervisory committee must cease. More than ever there is serious work to be done by supervisors requiring commitment and dedication. I urge supervisors to rise now to the challenges of the time.

Immediate Issues

Dividend

Great care and prudence must now be exercised in deciding on the level of dividend and interest rebate to be paid to members. Certain important

prerequisites must be addressed and fulfilled before a dividend is decided. Among these are the following:

Honest Accounting

Directors and supervisors must go to some lengths, with their auditors, to fully satisfy themselves that the financial statements for the year show a true and fair view. Nothing less than meticulous compliance with the provisions of the Credit Union Act with regard to the preparation of the financial statements is acceptable. Honest accounting is the bedrock of financial stability. No matter how unpleasant any financial issue for a credit union is, it must be addressed in the accounts with prudence, courage and honesty.

Level of Reserves

We have recently issued a regulatory direction with regard to the levels of reserves which must exist before a dividend can be paid. This direction must be observed. In times of stress resources must be conserved rather than dissipated.

Prospects for the coming year.

Credit Unions should prepare projections of the likely financial outturn for the coming year and take account of any threat to their reserves which might arise as a result. Consideration should be given to this before deciding on a dividend for the current year.

If there are any doubts about how credit unions should address the dividend issue their officers should contact my office for guidance on the matter.

Downstream Consequences of Past Errors of Policy

Property and Business Lending

Most credit unions will now have realised the dangers of lending for property projects. Property value volatility has seen the demise of many financial institutions internationally over many years. While the losses sustained by some credit unions in property lending have been severe they are not so serious as to threaten the stability of the movement overall. There now remains a cleaning

up process to be addressed in respect of loans which have gone bad. A sustained effort must be made in such cases to pursue the borrowers for full recovery using the appropriate professional assistance, where necessary.

Business lending must be kept under strict control from now on and must now be the subject of proper analysis and full consideration before any decisions are made to advance members funds for such purposes. Business lending should be regarded as exceptional and must never be permitted to pose a risk to the credit union's stability by virtue of its size.

Investments

While credit union losses on investments have been declining in some cases, there nevertheless remains a substantial portfolio of residual investments which needs to be carefully managed. We would wish to see all but the most conservative and liquid investments unwound in a prudent fashion and members' funds held in secure liquid form in credit institutions where the amount deposited is the subject of a statutory guarantee.

Policy matters under consideration

A number of important policy matters are currently under consideration by the Minister.

Central Liquidity Mechanism

Solvent credit unions which suffer a temporary liquidity shortfall need access to a reliable liquidity support mechanism funded from within the movement. We have been pressing for such a facility for some time. Following consultations with the various stakeholders under the auspices of the Department of Finance, Draft Heads of Bill were recently finalised by my office and these have been circulated by the Department to the representative associations, for their consideration. We would hope that legislation for the creation of the CLM will be enacted in 2010.

Solvency Support Mechanism.

Although members' savings are guaranteed in the unlikely event of a credit union collapse, credit unions themselves do not enjoy a government guarantee

of stability and it therefore very important that any credit union which becomes insolvent should have access to support facilities to prevent its collapse, should this become necessary. The collapse of a credit union would have reputational consequences for the movement as a whole. While most credit unions could apply to the League for support from the SPS it is unclear as to whether its resources would be adequate to deal with the collapse of a large credit union and especially if more than one got into difficulty. We are seeking to have this matter addressed.

Section 35 and Rescheduling

The issue of the rescheduling of credit union loans has come to the forefront arising from the economic crisis. Clearly, credit unions must deal with their members who are in arrears in a reasonable and supportive way. The issue as it now arises is that where a credit union has reached the limits imposed by the provisions of Section 35 of the Act, rescheduling of loans may push them into non-compliance. This arises, I understand, from the practice of giving the members whose loans are rescheduled an entirely new loan agreement and this in turn has the effect of extending the term of the loan. This in turn, affects the degree to which the credit union is in compliance with Section 35.

Our concern in this process is that appropriate provisions should be created for bad & doubtful debts. I understand that when a new (rescheduled) loan is issued that the arrears which may previously have arisen on the original loan are normally deleted from the computer system. This, in turn, affects the calculation of Resolution 49 in a negative way. Consequently, rescheduling of loans without simultaneously creating appropriate provisions can pose a potentially serious and hidden danger to the financial stability of credit unions due to the suppression of provisions which should rightly be made otherwise.

Could I also caution against allowing the natural sympathy which a credit committee may feel towards a deserving rescheduling case, to interfere with proper accounting. No matter how deserving the case, if a member cannot comply with the commitments given in the original loan, then that loan is, by definition, impaired. The deserving case is no different, in the accounting sense, to the case of a member who could, but won't repay their loan. Therefore I would caution credit committees against allowing emotion to interfere with honest accounting. That is not to say that a deserving case should not be

rescheduled but if the loan is rescheduled the proper accounting treatment must be adopted.

A solution to the issues arising from rescheduling is being sought in that the Minister has directed that the group which considered the operation of Section 35 in 2007 should be reconvened to seek a solution to the matter.

The Performance of Supervisory Committees.

I have been puzzled for some time as to why the reports of the supervisory committee of some credit unions which are made to members, and which are contained in the annual report, often do not identify serious problems in the operation of the credit union which should be obvious to them. As elected officers of credit unions supervisors have an obligation among others to "*ascertain that all actions and decisions of the officers relating to the affairs of the credit union are in accordance with law and the registered rules.*" (Section 60(1)(d) of the Act). Furthermore the supervisory committee shall "*furnish a written report on the results of its examinations and enquiries under this section to the next annual general meeting....*" (Section 60(1)(e))

In looking into this matter I have had a study carried out of the reports to the AGM of the supervisory committees of many credit unions where we know there are problems of varying degrees of severity. The findings of the study indicate that there is something amiss with the way supervisory committees are reporting (or more correctly, not reporting, to their members).

In many, or even most instances, the supervisors report is quite inadequate. Even where there are obvious issues with the affairs of a credit union (e.g. an arrears problem, investment losses or governance issues) in very few cases is any reference made to such matters. In the case of the representative sample of supervisor's reports that were examined, very few could be considered to convey anything useful to the members. In some instances the reports were quite misleading. E.g. in one case the report stated that the affairs of the credit union are being conducted in a very satisfactory manner when this was obviously not true in that case.

Clearly there is a faulty understanding by supervisory committees of their obligations under the Act. Very many are failing in their obligations to their members in this regard. Even if supervisory committees are diligent in the conduct of their investigations unless their findings are reported to the members who elected them they would be failing in their statutory obligations. This situation must be corrected as a matter of urgency as members have a right to be made aware of the true state of their credit union's affairs, especially in the difficult times we are now encountering. I would intend that this matter should be the topic of discussion between my office and your executive in due course.

Mr. Chairman and delegates, that concludes what I wanted to say. I'd be glad to answer any questions you may have, now or later.