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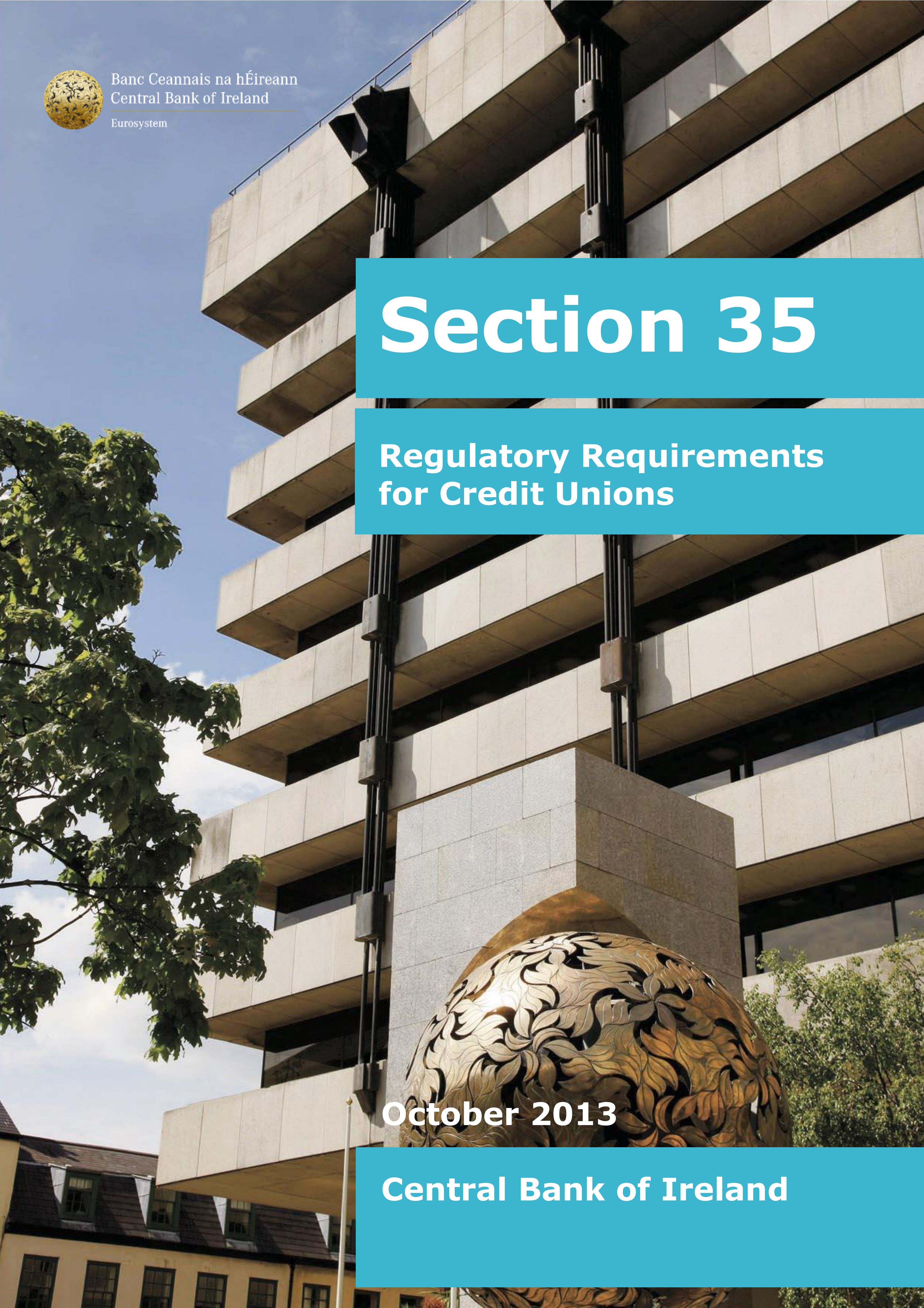

# Section 35

## Regulatory Requirements for Credit Unions

October 2013

Central Bank of Ireland

## Contents

## Section 35 – Regulatory Requirements for Credit Unions

## Introduction

The Central Bank Reform Act 2010 amended the limit for lending over five years set out in Section 35 of the Credit Union Act, 1997 ("Section 35").

With effect from 1 October 2010, the Section 35 limit on lending over five years was raised from 20 per cent to 30 per cent of total gross loans outstanding.[1] The amended lending limit was accompanied by regulatory requirements issued under Section 35(2C) of the Credit Union Act, 1997 relating to liquidity; lending practices for rescheduled loans; provisioning for rescheduled loans; and systems, controls and reporting **that apply to <u>all</u> credit unions irrespective of the percentage of lending over five years.** These requirements came into effect from 1 November 2010.

Following a review, the Section 35 requirements have been revised. The revised requirements are set out in this document (the "requirements") and replace the previous requirements imposed under Section 35. These requirements are effective from 1 October 2013.

The requirements are imposed by the Central Bank of Ireland (the "Central Bank") on all credit unions pursuant to its powers under Section 35(2C) of the Credit Union Act, 1997 by reason that the Central Bank considers that the requirements are necessary for the adequate protection of the savings of members of credit unions.

The requirements are set out in this document as follows:

- Section 1.1. reminds credit unions as to their obligations under Section 85 of the Credit Union Act, 1997;
- Sections 1.2 to 1.6 set out the requirements on liquidity;
- Section 2 sets out the requirements on lending practices for rescheduled loans;
- Section 3 sets out the requirements on provisioning for rescheduled loans; and
- Section 4 sets out the requirements on systems, controls and reporting.

[1] The limit on lending over 10 years remains at 10 per cent of the total gross loan book balance outstanding in relation to all loans made by the credit union. The longer term lending limits will continue to apply to those credit unions that are approved to avail of the longer term lending limits in accordance with Section 35(2)(a)(ii) and 35(2)(b)(ii) of the Credit Union Act, 1997.

## Section 35 – Regulatory Requirements for Credit Unions

Credit unions may be subject to regulatory action by the Central Bank for failing to comply with these requirements.

If a credit union knowingly contravenes any of the provisions of Section 35 including these requirements, the credit union shall be guilty of an offence.

Any legal proceedings, or an investigation, regulatory or enforcement action in respect of any provision of the Section 35 - Regulatory Requirements for Credit Unions that applied prior to the issue of these requirements may be continued, and any breach of the Section 35 - Regulatory Requirements for Credit Unions that applied prior to the issue of these requirements may subsequently be the subject of legal proceedings, investigation, regulatory or enforcement action by the Central Bank or other person, as if the requirements had not been amended or deleted and as if the Section 35- Regulatory Requirements for Credit Unions had not been revised and re-issued.

# Section 35 – Regulatory Requirements for Credit Unions

## Glossary

### Attached Savings

Attached savings are those savings which are attached to loans or otherwise pledged as security and are not withdrawable by members.

### Gross Loan

Gross loan is the total outstanding loan amount remaining to be repaid by a member.

### Liquid Assets

Liquid assets are cash and investments with less than three months to maturity, excluding the minimum reserve requirement.

### Liquidity Ratio

Liquidity Ratio is liquid assets as a percentage of unattached savings.

### Net Loan

Net loan is the outstanding loan amount remaining to be repaid by a member less any attached savings.

### Rescheduled Loans

Rescheduled loans are those loans where the repayment conditions have been altered by the credit union so that:

(1) the duration of the loan is extended; or

(2) the repayment amounts have been reduced for 4 or more months within the period of the loan;

and the loan was in arrears at the time of the repayment conditions being altered, or the loan would have fallen into arrears if the repayment conditions were not altered because the terms of the original loan agreement would no longer be met.

### Single or Lump Sum Repayment Loans

Single or lump sum repayment loans are those loans whose repayment takes the form of a single payment, or where the repayment schedule is less frequent than monthly.

### Unattached Savings

Unattached savings are those savings which are not attached to loans or otherwise pledged as security and are withdrawable by members. Unattached savings include budget accounts with a positive balance.

# Section 35 – Regulatory Requirements for Credit Unions

## 1. Liquidity

**Minimum Liquidity Requirements**

**1.1** Credit unions are reminded of the requirements contained in section 85 of the Credit Union Act, 1997 and the Credit Union Act 1997 (Section 85) Rules 2010, including, without limitation, the following requirements:

1.1.1 A credit union must at all times keep a proportion of its total assets in liquid form so as to enable the credit union to meet its liabilities as they arise[2].

1.1.2 Under the Credit Union Act 1997 (Section 85) Rules 2010, credit unions are required to maintain a minimum Liquidity Ratio of not less than 20 per cent on an ongoing basis.

1.1.3 Where it is considered appropriate, the Central Bank may set a ratio for a credit union, or a category of credit unions, that is higher than the minimum Liquidity Ratio.

**1.2** Notwithstanding this minimum liquidity requirement, it is the responsibility of the board of directors of each credit union to decide on the amount of liquid assets to hold in excess of the minimum, taking prudent account of the nature, scale and complexity of the credit union's business, its funding requirements and prevailing market conditions.

**1.3** Credit unions whose liquid assets are in excess of 20 per cent of unattached savings must continue to maintain liquid assets at such higher levels as are deemed prudent.

**1.4** The board of directors of the credit union must inform the Central Bank immediately should the Liquidity Ratio fall below 20 per cent and take the appropriate measures to restore the Liquidity Ratio to the required level as soon as possible. The timeframe in which the ratio will return to compliance must be agreed with the Central Bank.

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[2] Section 85(1) of the Credit Union Act, 1997.

## Section 35 – Regulatory Requirements for Credit Unions

**Additional Liquidity Requirements for credit unions where lending over five years is above 20 per cent**

**1.5** Any credit union that wishes to increase its lending over five years above 20 per cent of total gross loans outstanding must hold additional liquidity. The additional liquidity requirements are set out in the table below and these requirements must be met before the credit union increases its lending over five years.

| Lending Over Five Years | Minimum Liquidity Ratio |
|---|---|
| >20% and <25% | at least 25% |
| ≥25% and <29% | over 25% |
| ≥29% | at least 30% |

**1.6** The credit union must monitor its liquidity ratio on a continuous basis, and the board of directors of the credit union must inform the Central Bank immediately should the Liquidity Ratio fall below the required limits set out above. The credit union must cease making any further loans over five years until the Liquidity Ratio has returned to compliance and the credit union has received confirmation from the Central Bank that it is in order to do so.

## 2. Lending Practices for Rescheduled Loans

**2.1** Loans must only be rescheduled following a thorough credit assessment, supported by sufficient evidence, where the credit union has clearly established the ability of the member to repay in accordance with the revised terms of the loan.

**2.2** The credit union must require a borrower to submit an application to reschedule a loan. The application must be accompanied by the member's written consent to reschedule the loan and evidence of the change in the member's circumstances.

**2.3** Loans must only be rescheduled with the agreement of the member and where relevant, the guarantor. A new credit agreement[3] must be drawn up and the member must be made aware of any changes to the information contained in the original credit agreement, including changes to the cost of credit.

**2.4** The new repayment schedule put in place for **all** rescheduled loans must not be less frequent than quarterly.

**2.5** **Subject to 2.6, a credit union must not approve further agreements for additional credit where an existing loan has been rescheduled.**

**2.6** Where a member's ability to repay all credit owed and the proposed additional credit has been clearly established, the credit union may determine it prudent to grant additional credit to a member with a rescheduled loan where that rescheduled loan has performed in accordance with the new terms for an appropriate period, in most cases[4] not less than one year.

The provision held against the rescheduled loan must remain.

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[3] Which complies with all legal requirements including S.I. No. 281 of 2010 European Communities (Consumer Credit Agreements) Regulations 2010. This includes Regulation 11 which contains obligations on creditworthiness assessment.

[4] Of the total number of cases where a credit union has granted additional credit following the rescheduling of a loan, at least 90% of the rescheduled loans should have performed for a period of at least one year before the additional credit was granted. Where additional credit is being granted to a member with a rescheduled loan that has performed for less than one year, the rescheduled loan should have performed for a period of at least 9 months before the credit union considers granting additional credit.

Any additional credit granted to a member with a rescheduled loan that has performed in accordance with its terms for a period of less than one year must be approved by the board of directors of the credit union and the rationale for extending such additional credit must be clearly documented.

**2.7** Where a member's rescheduled loan has not performed in accordance with its terms for a period of at least one year, and where a member's ability to repay all credit owed and the proposed additional credit has been clearly established, in limited circumstances if the credit union considers it necessary, the credit union may grant small amounts of credit (maximum of €1,000 per member) to such members to cover exceptional expenses only. Any additional credit granted in these circumstances must be approved by the board and the rationale for extending such credit clearly documented. The maximum exposure limit for gross loans outstanding of this type at any one time is the higher of €5,000 or 0.5 per cent of the Total Regulatory Reserve (as defined in the Credit Union Act 1997 (Section 85) Rules 2009).

## 3. Provisioning for Rescheduled Loans

**3.1** The responsibility for provisioning for bad and doubtful debts remains with the board of directors of each credit union. The requirements set out below are minimum requirements. Credit unions must ensure that the level of provisions held against rescheduled loans is adequate and that the financial accounts show a true and fair view. **A credit union shall not amend, alter or change the terms of a loan for the sole or primary purpose of avoiding making bad debt provisions for their loan.**

**3.2** When assessing the minimum provision to be held under any of these requirements, the current net loan value amount shall form the basis for the calculation of the minimum provision to be held.

**Minimum provision required when a loan is rescheduled**

**3.3** When a loan is rescheduled a minimum provision must be made against the loan. **This minimum provision must be the higher of 20 per cent of the net loan and any provision that existed at the time of reschedule.**

This minimum provision must be identifiable as a provision for rescheduled loans and capable of being inspected and audited.

In exceptional circumstances, where the loan is not in arrears at the time of reschedule, the loan reschedule has resulted in the term being extended by a fixed period of 6 months or less and the credit union has evidence that the loan will return to the original payment plan following the fixed period, a credit union may review this requirement. Where such circumstances arise and the credit union determines it is prudent not to hold the full provision of 20 per cent of the net loan, the decision must be reported to the board of directors of the credit union and the rationale must be documented.

**3.4** The minimum provision required under Requirement 3.3 must be maintained until the **loan is repaid in full or written off.**

**3.5** The financial impact of default associated with loans with atypical arrangements, for example single or lump sum repayment loans, can be significant. Accordingly, where such loans are rescheduled, an assessment must be made to determine whether a further provision should be made for the loan in addition to the minimum provisioning requirement set out in Requirement 3.3, and where the assessment determines that further provision should be made, the credit union shall make that provision.

**3.6** At the time of the initial reschedule, a trial period of up to a maximum of four months may be agreed with the member, documented and applied to a rescheduled loan. The credit union must hold the minimum provisioning requirement, in accordance with Requirement 3.3, from the initial reschedule date. Any alteration of the repayment conditions at the end of the trial period is not considered a second reschedule.

**Provision required for rescheduled loans that perform in accordance with the new terms for at least one year**

**3.7** Notwithstanding Requirement 3.4, where the member has complied with the terms of the new loan agreement for a period of **at least one year** and the provision held against the rescheduled loan is greater than 20 per cent of the net loan then the credit union may, if it deems it prudent, reduce the provision to 20 per cent of the net loan.

**Provision required for rescheduled loans that fail to perform in accordance with the new terms**

**3.8** Additional provisions must be made for rescheduled loans that fail to perform in accordance with the new terms. The graduated provisioning requirement for such loans is set out in the table below. The **minimum provisioning requirement** is calculated based on the **combined weeks in arrears** which is '*the number of weeks the loan was in arrears at the time of reschedule* ***plus*** *the number of weeks the loan is in arrears since the loan was rescheduled'.*

| Combined Weeks in Arrears[5] | Minimum Provision Required (% of Net Loan) |
|---|---|
| 0 – 26 weeks | 20% |
| 27 – 39 weeks | 40% |
| 40 – 52 weeks | 60% |
| 53 weeks or over | 100% |

The Appendix contains two illustrative examples[6] of the minimum provision required for rescheduled loans that do not perform in accordance with the new terms following reschedule.

[5] Combined Weeks in Arrears should be calculated using the principal amount in arrears. Interest arrears should not be included.

[6] These examples are for illustrative purposes only and are not intended to cover all circumstances.

**Provision required for loans that are rescheduled more than once**

**3.9** Any loan that is **rescheduled more than once** must be provided for in full and the full provision must be maintained until the loan has been repaid in full or written off.

**3.10** Notwithstanding Requirement 3.9, where a rescheduled loan that has been rescheduled more than once has performed in accordance with the new terms since the last reschedule on a continuous basis and for a period of not less than one year, the credit union may review the level of provision held if it considers this appropriate but the level of provision held for such a loan must not be less than the minimum requirement of 20 per cent.

## 4. Systems, Controls and Reporting

**4.1** Credit unions must enter full details of all rescheduled loans in a **Register of Loan Amendments**. Rescheduled loans must be clearly designated and identifiable in the records of the credit union and must be capable of being audited. It must be possible to generate detailed reports on all rescheduled loans from these records for inspection by the Central Bank.

**4.2** Credit unions must monitor rescheduled loans on an on-going basis to assess the performance of each rescheduled loan against the new credit agreement and must report on rescheduled loans to the board of directors of the credit union at each monthly board meeting.

**4.3** Credit unions must ensure that they review their total loan portfolios, including rescheduled loans, on a quarterly basis to verify the adequacy of the provision for bad and doubtful debts, and that any resulting adjustments to the provision are incorporated into the monthly management accounts submitted to the board, and the Prudential Returns submitted to the Central Bank.

**4.4** Credit unions must undertake a full review of the bad debt provisions, including the provisions held against rescheduled loans, as part of the year-end annual accounts preparation and audit process.

**4.5** Section 35(2F) of the Credit Union Act, 1997 provides that credit unions must ensure they have the appropriate processes, procedures, systems, controls and reporting arrangements in place to monitor compliance with the Section 35 limits and these requirements.

**4.6** Credit unions must submit a quarterly report on rescheduled loans to the Central Bank in such format as the Central Bank may require. This report forms part of the Prudential Return that all credit unions are required to submit on a quarterly basis and **must be received by the Central Bank no later than 21 days following the reporting period end in accordance with the timelines set out below.**

| Reporting Period | Submission Deadline |
|---|---|
| 31 December | 21 January |
| 31 March | 21 April |
| 30 June | 21 July |
| 30 September | 21 October |

## Appendix – Illustrative examples of rescheduled loans that fail to perform in accordance with the new terms[7]

**Example 1 –** Loan that is **not in arrears** is rescheduled and the loan subsequently fails to perform in accordance with the new terms.

A **minimum provision of 20 per cent** is required **at the time of reschedule**. The table below shows the minimum provision required **over time** as the rescheduled loan **falls in arrears** and the position if the **arrears are subsequently repaid in full.**

| Loan performance over time | Weeks in Arrears since Reschedule | Combined Weeks in Arrears | Minimum Provision Required |
|---|---|---|---|
| Loan is rescheduled (**No arrears** at the time of reschedule) | 0 | 0 | **20%** |
| Loan falls 10 weeks in arrears following reschedule | 10 | 10 | **20%** |
| Loan falls 27 weeks in arrears following reschedule | 27 | 27 | **40%** |
| Arrears repaid in full.  Loan is 0 weeks in arrears following reschedule | 0 | 0 | **20%** |

**Example 2 –** Loan that is **30 weeks in arrears** is rescheduled and the loan subsequently fails to perform in accordance with the new terms.

A **minimum provision of 40 per cent** is required **at the time of reschedule**, the table below shows the minimum provision required **over time** as the rescheduled loan **falls in arrears** and the position if the **arrears are subsequently repaid in full.**

| Loan performance over time | Weeks in Arrears since Reschedule | Combined Weeks in Arrears | Minimum Provision Required |
|---|---|---|---|
| Loan is rescheduled (**30 weeks in arrears** at the time of reschedule) | 0 | 30 | **40%** |
| Loan falls 10 weeks in arrears following reschedule | 10 | 40 | **60%** |
| Loan falls 27 weeks in arrears following reschedule | 27 | 57 | **100%** |
| Arrears repaid in full. Loan is 0 weeks in arrears following reschedule | 0 | 30 | **40%** |

[7] These examples are for illustrative purposes only and are not intended to cover all circumstances.

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