Roger Marsh and Chris Donald
Prudential Regulation Authority
20 Moorgate
London
EC2R 6DA

30th September 2015

Dear Sirs,

RESPONSE TO CONSULTATION ON REFORM OF THE LEGACY CREDIT UNIONS SOURCEBOOK

This response represents the views of the FCA Smaller Business Practitioner Panel and the Financial Services Consumer Panel.

The FCA Smaller Business Practitioner Panel is a statutory body representing to the FCA the interests of practitioners of firms of small or medium size within their sector. The Panel includes the interests of Credit Unions within its membership. The Financial Services Consumer Panel is an independent statutory body set up to represent the interests of consumers in the development of policy for the regulation of financial services.

Both Panels have considered the consultation, and have a number of points we wish to make about the proposals.

Overall

Our overall concern is that the proposals may have the effect of restricting the business of credit unions the savings, loans and mortgage market place by introducing further restrictions that will inhibit the growth of the whole sector. Credit unions provide an important source of financial products which add to consumer choice in sectors where the customers' choices may be limited. We have concerns that there has not been sufficient recognition of the different types of credit unions, that the rationale behind the proposals is not always clear, and the proposals could mean that credit unions are unable to continue to provide services to the least well off. We also consider there are competition issues with the proposals.

We would like to see more recognition of the unique business model of credit unions. There is no doubt there are issues in the sector, but we are concerned that credit unions can be seen as inconsequential in the Financial Services sector, and that there is therefore little will to 'save' those that may fail. For example, currently there are some credit unions closing and requiring the FSCS to step in, but some of these could have been merged with a neighbouring credit union, had the regulations allowed for this to happen.

Below are some of the key issues in relation to the proposals in the Consultation Paper.

1. Restrictions on Credit Unions

The proposed regulatory changes provide credit unions with no additional powers or opportunities to develop their business and serve more people, particularly those with fewer financial choices. Indeed, the proposals include many regulations (such as a restrictions on interim dividends; caps on deposits; and maximum loan sizes) which actually curtail the activities of the largest (and most successful) credit unions in the sector. Without the ability to grow, credit unions could become irrelevant in the near future.

The Consultation Paper on CREDS is a real opportunity to provide a more level playing field for successful credit unions and also an opportunity to help less successful credit unions plot a path to sustainability through consolidation and mergers. The proposals, as they stand, do not achieve this.

2. Long-term development of credit unions

The proposed regulatory changes deliver 'cliff edge' capital ratios for growing credit unions whereby:

- A credit union which moves from 4,999 members to 5,000 members OR whose deposits move from £4,999,999 to £5,000,000 will immediately move from a capital ratio of 3% to 5%; and
- A credit union which moves from 9,999 members to 10,000 members OR whose deposits move from £9,999,999 to £10,000,000 will immediately move from a capital ratio of 5% to 10%.

Credit unions are self-capitalised institutions and consequently 'overnight' increases of 66% and 100% in capital ratio are not feasible and will result in small and medium sized credit unions being forced to turn away members and savings in order to ensure that they do not trigger these thresholds. Whilst we note that most UK credit unions are not immediately impacted by these proposals, the effect of the proposed regulations will have a significant mid/long term detrimental impact on the ability of credit unions to provide the UK population with access to alternative financial products. These capital requirements are onerous compared with other sectors. Capital requirements need to be proportionate and subject to risk weighting.

3. Credit Unions' Objectives

The draft regulations propose that credit unions must return an average 6% on their loan book if they wish to provide what are termed as 'additional activities' (but which are in fact current standard activities for large credit unions).

The proposed introduction of a minimum average lending rate is contrary to credit unions' statutory objective of providing affordable credit. We consider it is preferable that credit unions, as businesses, should be able to determine their own 'returns' based on their ability to serve their local market place rather than on an arbitrary ratio.

4. Internationally Recognised Best Practice

The ‘internationally-recognised best practice’ on which the regulatory proposals are based are the ‘PEARLS’ ratios as promoted by the World Council of Credit Unions (and which were, in fact, developed for credit unions in Guatemala, not the UK). The proposed regulations take the ‘excellence goals’ from PEARLS and turn them into minimum standards for UK credit unions and, as a result, set minimal prudential standards which are in excess of Internationally Recognised Best Practice.

Although the credit union sector seeks to maintain appropriate standards, the problem arising from the transformation of ‘excellence goals’ into minimum standards is compounded by the proposed regulations requiring absolute adherence to all of the minimum ratios at all times - otherwise the credit unions will have to withdraw their services.

It is possible that the proposals, if implemented, will lead to credit unions chasing ratios rather than serving their members which would not be in the best interest of either the industry or consumers.

5. Cap on deposits

The draft regulations propose that credit union members will be restricted to a maximum number of shares (deposits) equivalent to the prevailing FSCS compensation limit. This is inappropriate as:

- If the objective is to facilitate the prompt and efficient resolution of a failed credit union, there is no correlation between the proposed cap and prompt and efficient resolution.
- The introduction of an FSCS compensation level limit on deposits would not impact on the prudential safety and soundness of a credit union as it only could apply after the cessation of trade.
- As credit unions compete with banks and building societies for deposits, this ‘credit union only’ proposal will restrict competition within the sector.
- The proposed regulations prevent credit union depositors from having access to the FSCS and, therefore, by effectively creating a two tier FSCS scheme, affect both credit unions’ business and customer protection.
- The FSCS compensation level can change due to external factors such as exchange rates. Tying the maximum level of deposit allowed to be held in a credit union to an unrelated external measure presents a risk to both credit unions’ business and consumer understanding of their protection levels.
- The current and proposed regulations already contain a specified cap on deposits (being the greater of £15,000 or 1.5% of total non-deferred shares). There is a prudential rationale for this cap and, due to its construct, it applies equitably across all sizes of credit unions.

We therefore believe the addition of a further FSCS based restriction is unnecessary.

6. Cap on loans

Credit unions currently operate under ‘large exposure’ regulations, which allow them to issue loans of up to the value of 1.5% of non-deferred shares. These rules are proportionate and allow credit unions to grow their larger loans in line with the growth of their business. The proposed regulations retain these large exposure rules but supplement them with a maximum overall lending limit of £500,000. The introduction of a £500,000 cap is not progressive and could be prudentially detrimental to larger credit unions and have the effect of stifling their growth and profitability.

We would be happy to discuss any of these points further, if required.

Yours faithfully,

Clinton Askew
Chair, Smaller Business Practitioner Panel

Sue Lewis,
Chair, Financial Services Consumer Panel