Credit Unions: An Endangered Species in Ireland's Blighted Banking Landscape?

Last week another local community based, independent, ethical financial institution ceased to exist. According to data published in December by REBO around 204 credit unions with assets totalling €8 billion, are involved in restructuring. The net result of this will be the loss of up to 113 small local credit unions as independent and autonomous institutions. These local institutions will be lost through no fault of their own but rather as a result of a reckless and profit-hungry private bank duopoly.

The good news is that these vital credit unions will continue to operate but as part of the larger credit unions into which they are being merged. Their local CU offices will remain open, their friendly and dedicated staff will continue to greet customers by name and to dependably provide the essential services they have provided for many decades to their customers, who are both members and owners. Indeed, because they have merged with larger and neighbouring credit unions their opening hours may be increased and the range of financial services they provide is likely to be enhanced.

It is arguably good news too that the ongoing restructuring and consolidation process will lead to a smaller number of stronger larger credit unions with a greater capacity to compete, to innovate and to thrive in today's evolving and more challenging financial services sector. There has been, it would seem, broad support for the strategy of restructuring and consolidation in the credit union sector. The Commission on Credit Unions, the Minister and Department of Finance, the financial regulator/Central Bank, the Registrar of Credit Unions, and credit union representatives have endorsed and been proponents of consolidation. The ongoing process, co-funded and aided by REBO, the credit union restructuring board, is already well advanced and will not be reversed. In the coming months we can expect the Minister for Finance to join with Central Bank, REBO and credit union representatives to celebrate the completion of the 100th successful merger. The managers and staff will win deserved public praise for proactively embracing change and for their success in advancing the interests of their members and the broader credit union movement. The good news ends there.

There is a grave danger in this broad sweep toward credit union consolidation that the real challenges credit unions now face are not now being, and will not be effectively addressed. The thrust of Government policy has been to restore the duopoly of the two private banks which, having failed, continue to dominate Ireland's financial system.

1. There is a very real risk that, despite the obvious logic and benefits of consolidation that the larger merged credit unions will continue to face the very adverse market conditions which are a still-enduring legacy of the 2008 crisis and which resulted from the actions of the dominant private banks. Reckless lending by the banks led ultimately to the collapse of property prices, negative equity, unemployment, over-indebtedness, mass emigration and years of austerity.

The consequent impact on credit union income sources; (i) the sharp 50% fall in Irish personal loan demand and (ii) the steeper decline in returns on CU investments, has been devastating. It remains a major problem. The decline in these income streams can deplete the albeit ample reserves of credit unions. Unless and until it is addressed, it will serve to undermine the viability of their core business model, their ongoing financial performance and the future prospects of Ireland's credit unions

2. There is also a danger that the Minister of Finance and the sector policy makers and regulators (CBI/RCU) will neglect to ensure that i); a more level playing pitch and, ii); the conditions for balanced competition prevail following restructuring._Credit Unions and their members have contributed to the stability and resilience of the Irish financial system and have been supportive of the distressed private banks. These private banks compete against credit unions for customers for personal loans and for the other financial services credit unions provide. Yet credit unions are restricted by regulations from offering many of the financial products and services those banks provide.
Moreover, credit unions have been compelled by regulation to place much of the un-lent savings of their members in short/medium-term deposit accounts in the private banks, ie; their competitors. Such deposits currently yield extraordinarily low interest rates of around 0.6% p.a. at present. Thus both policy and the regulatory framework serve to afford the banks an unreciprocated advantage and a benefit at the expense of credit unions and their owner-members.
The Commission on Credit Unions report acknowledged that the (credit union) ‘sector has arguably suffered a competitive disadvantage’. *Section 2.6.9.* of the report states “It is important to ensure that the conditions for balanced competition prevail following restructuring of the Irish financial services system”. They do not.

3. Regulatory impact assessments (RIAs) are a necessary safeguard to ensure no sector or business is subjected to unjust, inappropriate or excessive regulatory measures. The credit unions, having demonstrated far greater prudence, compliance and resilience and far better financial performance than their private bank competitors have none the less been subject to disproportionate and unduly burdensome regulations and rule changes since the 2008 crisis. Credit unions did not contribute to causing Ireland’s financial crisis. Moreover, they have shouldered all of such costs and losses as were imposed on them without Government aid or subvention.
Most recently the Central Bank proposed a new tiered regulatory structure under which the regulatory burden would be proportionate to the scale of the institution and of the systemic risk it could pose. No Irish credit union poses a systemic risk. Upon the rejection of the tiered structure proposed the Central Bank applied the same onerous and burdensome regulations to even the smallest of credit unions.
Unlike the private banks credit unions have never been authorised to issue credit money thereby increasing the nation’s money supply. Banks issue credit money when they extend a mortgage loan using only the borrower’s signed promise to pay and the deeds lodged as collateral. Thus the ratio of a bank’s assets to it’s equity could be 20:1 or higher. Credit Unions can only lend from the pool of members deposits and paid up share equity. Their loans to assets ratio is currently a paltry 0.27:1.
In such circumstances and given the disproportionate regulatory burdens and narrow constraints imposed on credit unions, a rigorous, objective and independent expert regulatory impact assessment is necessary.
Moreover, in 2005 the Competition Authority report ‘Competition in the Banking sector in Ireland’ was published. It noted that the personal current account market is highly concentrated and it made 24 detailed recommendations focussed on promoting competition. All of those recommendations should now be implemented and the time has come for a follow-up study. It’s focus should be widened to identify how sectoral policies, market structures and regulatory frameworks may also be limiting or distorting competition in the Ireland’s financial services sector.

4: Irish consumers, taxpayers and companies have paid a high price for the policy failures of the Department of Finance, for the regulatory failures of the Central Bank entity and the recklessness of Ireland's private profit-maximising banks. The overarching lesson from Ireland's 2008-2015 financial and economic crisis is that consumers, taxpayers and firms should remain vigilant and should demand effective reform, greater transparency, accountability and responsibility…and the break-up of the too-big-to-fail banks which dominate the sector.

Ireland's banking landscape is still dominated by the same two large private banks.

These two private profit-maximising banks still account for more than 70% of the market between them. Expert commentators have repeatedly pointed out that the market remains highly concentrated and that this poses risks for consumers and taxpayers alike.

It is understandable that given the immense challenge of bailing-out, recapitalising and disposing of these entities the Department of Finance has seemingly been preoccupied with that task for much of the past decade.

However, to prevent a recurrence of the housing-credit bubble it is essential that policymakers work to create a better balanced and more resilient banking sector. The proven means to achieve that goal is by ensuring that non-private, non-profit-maximising public, co-operative and community based institutions play a greater role. The National Treasury Management Agency, An Post Savings Bank and the (remaining) 300 Irish credit unions are the vitally important non-private financial institutions in the Irish financial system. With their democratic oversight, ethos of public/community service and non-profit-maximising business models these institutions could provide the necessary counterbalance to the intense competitive struggle between the two dominant profit-maximising banks.

Towards Community Banks- The Neglected Solution

There is an abundance of economic literature demonstrating the link between bank lending and cycles of boom and bust in real estate markets. As loans for real estate account for the bulk of all lending (c.75% plus) in any economy it is understandable that the leading banks compete aggressively to lend to developers and real estate buyers. Land and buildings inevitably account for the bulk of the loan collateral held by banks and as real estate prices rise (due to population growth, urbanisation, FDI, inflation, etc), the bank's collateral values and hence the lending capacity of the bank rises further. This positive feedback gives rise to a situation where lending for real estate generates its own demand and inflates an unsustainable housing/land-credit bubble.

With two disproportionately large private banks dominating the Irish domestic financial services market it is inevitable that they compete aggressively to lend to developers and real estate purchasers. That greater intensity of competition resulting from market concentration may well explain why Ireland's banking collapse was among the largest in size relative to GDP ever to occur.

Given the too-big-to-fail (tbtf) size of both AIB and Bank of Ireland the Government had arguably no policy choice but to bail-out and recapitalise them. Having embarked on that course the Government has been compelled to give priority to their needs and to seek to restore them fully to secure the maximum return for taxpayers upon the planned sale of its substantial stakes in their equity to private investors.

The policy-making capacity of this Government and of future Irish governments and of the current and future ministers for finance was thus compromised and even arguably co-opted by the too-big-to-fail private banking duopoly. The bail out of

these banks has required the use of the NTMA and its subsidiaries, the NPRF and NAMA to provide funding and fulfil supporting roles. Moreover, for so long as the Minister and Department of Finance retains a stake in the tbtf private banks, its freedom to objectively govern and regulate the Irish financial system in the national interest is compromised and partly if not fully disabled.

Professor Richard Werner, a leading economist and banking expert has identified two features of national financial systems which enable countries to avoid destructive cycles of boom and bust during periods of economic growth. Window/credit guidance to prevent excessive lending into over-heated real estate markets is one policy which has proven successful. The other proven remedy is to have public banking institutions; i.e.; a diversity of non-private, non-profit-maximising banks playing a large role in the financial system.

The overall response of the Department of Finance to the banking crisis has been, first and foremost and at the expense of other choices, to restore AIB and BoI to the dominant market positions in which they pose a too-big-to-fail threat, and in which their performance has historically been abysmal.

To effectively rehabilitate the Irish banking landscape, to ensure fair competition, diversity and choice, to enhance resilience and reduce the risk and threat posed by the failure of one or more institutions, Ireland needs the counterbalance of a greater number of non-private, non-profit-maximising financial institutions.

By ensuring a level playing pitch and maintaining the conditions for balanced competition Government could ensure credit unions and An Post are not stifled but can fulfil more of their potential and play a bigger role in the market. The NTMA, as a public institution should collaborate with public and non-profit-maximising institutions rather than being a mere tool, cushion or partner for the duopoly.

The immense potential of public savings banks, like the exemplary German Sparkassen, to provide more secure and prudential financial services in Ireland has been highlighted over several years by the Public Banking Forum of Ireland and more recently by the finance spokespersons of several political parties. Having lent expertise and delivered a detailed proposal to the Department of Finance the Sparkassen Foundation's generous offer to assist in establishing such banks should not be neglected and in effect rejected by the Minister.

The role of the Credit Unions and of the An Post savings bank could and should have been increased and enhanced in the years following 2008 given the failure of their competitors. However, the credit unions were themselves victims of the crash and have commendably been busy addressing the very negative impacts without external support. An Post's Savings Bank is controlled by the NTMA and, like the Government, the NTMA's policy is compromised by its interests in the private bank duopoly, by the substantial public investment in those banks and the objective of securing the return of those sums.

The credit unions and their representative the Irish League of Credit Unions are seeking a greater role in Ireland's financial system. With close to €8 billion in unlent deposits the credit unions have ample resources and they seek to invest these for the benefit of their members and the wider community rather than their competitors. In their current Six Steps policy lobbying document they offer to invest in state-backed social housing construction with housing associations. It is appalling that current regulations preclude them from making any such socially beneficial investment.

Credit Unions in many countries have formed federations to establish and operate banks like RABO Bank (NL) and Credit Agricole (F). Irish credit unions could likewise co-operate at regional level to establish regional or community-type banks. These can be structured to meet bank governance and regulatory requirements while operating as a dedicated service provider for their stakeholders and their region or community. These community/regional banks could be conservatively leveraged to have total loans of five times their equity (5:1) and this would increase the supply of credit available for much-needed investment in sectors of the economy. While much of the necessary capabilities and capacities required are already to be found in the credit unions they could none-the-less avail of the expert co-operation available from the German Sparkassen Foundation.

In conclusion, more than one hundred independent local credit unions will be lost within little more than one year through no fault of their own but largely as a knock-on consequence of the failure of Ireland's largest private banks. These institutions were a credit to their founders, their volunteers, managers and staff. The remaining larger credit unions will continue to face adverse conditions and more may be lost in the years ahead. The Irish domestic banking system remains highly concentrated, private and monocultural. Neither it nor the Government appears capable of addressing the problematic escalation of rents and the ongoing housing supply crisis.
The Department of Finance under the stewardship of Minister Michael Noonan has arguably rededicated itself to serving the largest private banks. It abandoned the credit unions, tenants and homebuyers to fend for themselves. It has shown no vision, imagination or lateral thinking nor any appreciation of the need for and benefits of non-private financial institutions. The Minister and his Department have shown that Ireland Inc. remains by-and-large a wholly owned subsidiary of Bank of Ireland and AIB and the Irish people will continue to depend largely upon them for their shelter, employment and over-priced financial services.

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