

**RESPONSE OF THE IRISH LEAGUE OF CREDIT UNIONS TO THE DEPARTMENT OF
FINANCE’S CONSULTATION ON:
FINANCIAL SERVICES LEGISLATION: CONSULTATION ON CONSOLIDATION AND
SIMPLIFICATION BILL**

INTRODUCTION

The Board of Directors of the Irish League of Credit Unions (‘the League’) welcomes this opportunity to make a submission in respect of the Department of Finance’s *Consultation on Consolidation and Simplification Bill*.

GENERAL COMMENT

The League in general welcomes any move that may be taken by the Department of Finance to achieve consolidation and/or simplification of legislation. The League believes that such a move would be of benefit to all financial service providers and also to the users of those financial services because of the unconsolidated and legalistic way in which legislation is currently drafted and enacted. Such legislation and regulation, if not rectified, is likely to lead to a stifling of innovation and development. Also, such legislation is unlikely to be able to be changed in a speedy manner to cater for changes in markets and market trends. The financial services market does not have a single culture and is not an homogenous market. Legislation will have to recognise and provide for this.

The League would also like to make it clear that the financial services market in Ireland is a diverse one, ranging from small, not-for-profit credit unions run by volunteers to large multi-national conglomerates that earn in excess of €1 billion profit per annum. Any consolidation would need to recognise the diversity that exists in the market.

The Irish Financial Services Regulatory Authority (‘IFSRA’) regulates diverse sectors and entities within the broad spectrum of the financial services market. Indeed, the financial service providers that are regulated by IFSRA were previously regulated by a number of separate regulators. These sectors require different types of regulation and legislation. There is a danger that if a one size fits all approach is adopted that the smaller entities in the market will find it more difficult and more costly to comply with legislation and regulation and may result in disproportionate levels of regulation

across the sectors. Regulation should be proportionate for the different sectors that exist in the financial services market. This is a key principle of the recent White Paper, *'Regulating Better'*.

The League would like to see legislation that:

1. reflects the diversity that is inherent in the financial services market along the current sectoral approach that exists;
2. recognises the particular characteristics of the financial services providers operating in each sector;
3. allows such diverse providers to flourish in a market that is safe and sound;
4. provides for financial service providers to be properly (but not overly) regulated, without stifling development and innovation in the market; and
5. offers protection to consumers of financial services.

CREDIT UNIONS IN THE FINANCIAL SERVICES MARKET

Credit unions are unique in the financial services sector in Ireland. There are a number of differences that set credit unions apart from other financial services providers. These include the following:

- credit unions are not-for-profit financial co-operatives;
- credit unions are run by volunteers; this is recognised in legislation through the Credit Union Act 1997;
- credit unions do not have customers, credit unions have members; the members of a credit union own the credit union unlike the customers of other financial service providers;
- credit unions are community based organisations with a very different focus to commercially driven financial service providers; and
- credit union services are provided to members across the income divide and remain for many in rural and disadvantages communities their only access to financial services.

IFSRA have stated, most recently in its *'Strategy for 2005'*, that:

The Registrar of Credit Unions will further develop the credit union regulatory system aimed at protecting members' funds through having a properly differentiated supervisory approach.

The League welcomes the fact that IFSRA has recognised the fact that credit unions, because of the ethos and philosophy of the credit union movement in Ireland, require a properly differentiated supervisory approach. The acknowledgement of this fact demonstrates IFSRA's recognition that a one size fits all approach to the regulation and supervision of the financial services sector would not be desirable or indeed beneficial to financial service providers or the ultimate consumers of financial services.

The League would point out that the credit union ethos and philosophy have been accepted by the European Commission in its revised proposal of the proposed Directive on Consumer Credit by subjecting credit unions to a lighter regime within the scope of the Directive. In so doing the Commission has recognised the important role of credit unions in the financial services market. It is expected that this will be taken on board by Irish legislators when drafting legislation in the future.

The League also has concerns that regulation, or more appropriately over-regulation, may have an impact on competition in the marketplace. It is obvious that larger entities making greater profits will be able to absorb greater regulatory and compliance costs. Overburdening smaller entities with similar compliance and regulatory costs obviously creates competitive difficulties. 'Regulating Better' has recognised the difficulties that small and medium sized enterprises face in the current regulatory environment. Many credit unions would also face similar difficulties in the financial services market. This is evidenced by the sharp reduction of credit unions in other jurisdictions (United Kingdom, Australia, United States, Canada and New Zealand) following the imposition of new regulatory requirements. The effect of such requirements has been to remove access to mainstream financial services for many marginalised groups. The irony is that governments in some of these jurisdictions have had to step in and establish community development credit unions to meet this need.

DEPARTMENT OF FINANCE PROPOSALS

It appears that the scope of the proposal from the Department of Finance is to consolidate in a single Bill legislative instruments that lay down the regulatory

requirements that apply to financial service entities. In order to achieve this, the Department of Finance is currently contemplating two models:

- a cross-sectoral approach; and
- a modified sectoral approach.

Cross-Sectoral Approach

Such a Bill would be drafted on the basis that its provisions would apply to all sectors regulated by IFSRA, with minimum sectoral ‘add-ons’. It appears that the Department has looked at the United Kingdom and Danish models in this regard. The League understands that such legislation would set out general conditions for authorisation across all sectors but IFSRA would then apply sectoral specific conditions for authorisation. The same would apply to the areas of supervision, treatment of customers etc. However, the application of the legislation would be to all sectors.

Modified Sectoral Approach

Such a Bill would be drafted on the basis of the present sectoral approach, with different chapters applying to different sectors but with maximum harmonisation of provisions within those chapters. The League understands that such an approach would consolidate the legislation affecting financial service providers into one Act but that such an Act would deal with each sector on an individual basis, recognising such sectors in individual chapters of the Act. However, it appears that there would be a cross-over in relation to particular areas of the legislation where general principles would be applied but these would be dealt with specifically in the sectoral chapter.

The League has noted the differences between these approaches. However, in the League’s view there are a number of requirements in relation to any legislation that must be adhered to when contemplating drafting of new legislation.

REQUIREMENTS OF LEGISLATION

The legislation, if enacted, must provide certainty in all the areas that it covers. The Department recognises this point itself when it states that the Bill must contain sufficient detail to satisfy Constitutional requirements that legislation is an Oireachtas

prerogative. It is not a function for IFSRA to legislate and as such this is a point that must be borne in mind when drafting any new legislation.

However, IFSRA does have the key role in regulating the financial services industry. The regulatory environment should be developed from within a well-defined legislative framework. It is felt by the League that the '*Cross-Sectoral Approach*' that is being considered by the Department is not the best legislative model from which to frame regulation that is cognisant of the diversity that exists within the financial services market.

Any legislation must recognise the different emphasis of the sectors that exist within the financial services market. From the League's point of view, such legislation would require specific provisions that recognise the unique ethos and philosophy of the credit union movement within the financial service market. Legislation and regulation should also be cognisant of the risk posed by the different sectors in the market and legislate and regulate accordingly. This would mean that entities that pose a low risk would have a lower level of regulation according to that low level of risk. Regulation of the sectors should be proportionate.

Also, legislation and regulation should not be overly restrictive so as to limit competition either nationally or internationally. Often the cost of regulation and compliance places an unfair burden on smaller entities within a market. This should be borne in mind when framing legislation and imposing regulations.

The Department in its documentation refers to maximum harmonisation across sectors in relation to provisions contained in sectoral chapters in the '*Modified Sectoral Approach*'. The League has concerns in this regard. The adoption of maximum harmonisation across sectors may place unnecessarily high burdens on those sectors of the market that pose a much lower level of risk to confidence in the industry and to consumers. This in itself could act as a barrier to entry into certain markets which may itself inhibit competition in certain markets. What may be an acceptable legislative and regulatory burden for one sector may place an excessive burden on another sector that is unnecessary and impacts financially, administratively and competitively on that sector in an adverse manner.

It is important that legislation, and any subsequent regulation, does not stymie development and innovation within any sector of the financial services market. Legislation that is overly paternalistic and that results in over regulation in the market will prevent that market from developing to its maximum potential. It encourages the actors in the markets to be complacent with what they already have and makes product development less likely. This will have a knock-on effect for competition in the market and ultimately will not be positive for the consumer.

Clearly one of the differentiating factors between credit unions and other financial providers is that credit unions operate in all communities and draw membership across all income levels. At a time when other financial service providers have withdrawn from rural and disadvantaged communities credit unions remain the only providers of such services to these communities. Any legislation and subsequent regulation needs to be wholly cognisant of the negative knock on effect it may have on maintaining and indeed developing access to financial services.

CREDIT UNION ACT 1997

The Department has requested comments on technical deficiencies in existing legislation. It is the League's understanding that this process and consultation does not deal with any comments or submissions on the substantive nature of primary legislation that applies to the individual sectors of the financial services market. The existing Credit Union Act 1997 has been the subject of ongoing discussion between the League and IFSRA/Registrar of Credit Unions. Indeed, there is a commitment from IFSRA/Registrar of Credit Unions in its Strategic Plan 2005 to review the Credit Union Act. The League feels that there are certain provisions within the current legislation that restrict credit unions in developing their operations, particularly in the areas of:

- Lending; in particular the League feels that the restrictions on lending by a credit union imposed by the Credit Union Act, namely section 35, restricts the business development of some credit unions.
- Reserves, capital policy, limits on deposit taking, this matter has been addressed with the Registrar and attached herewith at Appendix I is a copy of

a paper previously submitted by the League to the Registrar in relation to these issues.

- Additional services to be provided by credit unions, in particular the League feels that the application and authorisation procedure that credit unions are required to comply with in relation to additional services is cumbersome and time consuming and stymies credit union development in the market.

This paper is not the correct forum in which to address these issues in detail but it is assumed that such issues will be addressed in any consolidation/simplification process and as committed to IFSRA/Registrar of Credit Unions in their recent Strategic Plan.

CONCLUSION

1. The League would not support any Bill that would be drafted on the basis that its provisions would apply to all sectors, with minimum sectoral add-ons (*'Cross-Sectoral Approach'*). The reasons for this are set out in the body of the paper.
2. The League supports the current sectoral approach towards legislation, where legislation is drafted specifically for individual sectors. The League further supports a process whereby the Credit Union Act 1997 will be reviewed during the course of 2005.
3. The League would support a Bill that would be drafted on the basis of the present sectoral approach, with different chapters applying to different sectors provided that:
 - the Bill wholly recognises the current sectoral approach that exists and that credit unions are duly recognised and separately legislated for in such a process, by way of a separate chapter and that such a Bill will address the current deficiencies that exist in the legislation, some of which have been alluded to in this document;
 - it does not apply general principles across sectors in order to achieve maximum harmonisation across a diverse industry; and
 - the Bill provides that any secondary regulation of the industry is based on the current sectoral approach that exists.
4. Such a Bill should not be introduced without the performance by the Department of Finance of a regulatory impact analysis in order to assess the impact of such a proposed Bill on the financial services market. Such analysis should deal specifically with the effect of such a proposal on all sectors within the financial services market and should look particularly at competitiveness, development of the sectors, innovation and continued access to financial services by all communities and consumers.

5. When such analysis has been completed the findings should be made public and a further, more detailed, consultation should occur with the relevant stakeholders.