

Jwala Rambarran: The proposed new regulatory regime for credit unions

Feature address by Mr Jwala Rambarran, Governor of the Central Bank of Trinidad and Tobago, at the Sixty Third Annual General Meeting of the Telephone Workers' Credit Union Co-operative Society Limited, Port of Spain, 16 March 2013.

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Ladies and Gentlemen,

I sincerely thank the Board of Telephone Workers' Credit Union for the kind invitation to deliver the feature address at your Sixty Third Annual General Meeting. It is indeed an honour for me to be part of this occasion.

In June 1950, Telephone Workers' Credit Union opened its doors with 38 members and a share capital of \$51. Sixty three years later, you can boast a membership in excess of 5,000 and a resource base of nearly \$415 million. This enduring journey of building wealth for generations of your members is certainly testimony to the significant resilience of Telephone Workers' Credit Union and a clear indication that you are living up to your motto "**Progress through Self Reliance**".

In fact, I am aware of a few other credit unions whose journeys are broadly similar to Telephone Workers' Credit Union and which can boast of their own achievements. For this reason, I want to underscore that the Central Bank recognizes the important contribution that credit unions are making to our society, especially in reaching out to the ordinary working men and women who are underserved by traditional financial institutions.

Indeed, I find it a fitting tribute to the global credit union movement, which has always stressed the brotherhood of man that, the new Pope who is known for his concerns for the poor, chose for the first time the name of Saint Francis of Assisi, whose prayer is widely recognized as the official prayer of credit unions worldwide.

For more than 65 years, the credit union movement in Trinidad and Tobago has been putting this ideal of the brotherhood of man into practice in the socio-economic field. Credit unions have been helping their members to develop a savings habit, to educate them on financial matters, and to finance small business start ups, even while experiencing considerable turbulence and consolidation. Today, about one-third of the population are members of credit unions and collectively manage some \$9.5 billion in assets, or almost 4 percent of the total assets of the entire financial system.

In effect, Ladies and Gentlemen, the credit union movement has contributed to financial deepening in the Trinidad and Tobago economy, bringing financial services closer to their members, their families and their communities. And this, in turn, has encouraged greater financial inclusion for which I commend the local credit union movement.

Nonetheless, the growth and development of the credit union sector has taken place within a legislative framework that does not provide for formal prudential regulation and supervision. As you know, the present legislation governing the credit union movement – the Co-operative Societies Act – dates back to 1971 and falls short of a prudential framework to protect members' savings and to help safeguard the integrity of the domestic financial system.

I am reminded of the insightful words of Independent Senator Subas Ramkhelawan during his contribution last December to the debate on the Securities Industry Bill. Senator Ramkhelawan indicated that "*financial regulation on the whole is like the building of a fortress, and it is important in the building of a fortress that all the walls must be equally fortified, because the marauders at the gate will always look for the weakest point to infiltrate*".

We have indeed seen the marauders at the gate, breaching the fortress of regulation, both in the insurance and credit union sectors. And we are still experiencing the painful emotional and financial costs to our citizens and to our economy.

Accordingly, I would like to take the opportunity this morning to speak about issues related to the new proposed regulatory regime for credit unions, which is expected to come into effect sometime in the second half of 2013.

- First, I will explain why the Central Bank should be the prudential regulator for credit unions in Trinidad and Tobago;
- Second, I wish to highlight the key principles underlying the proposed credit union regulatory regime, and the fundamental differences between the Co-operative Societies Acts and the Draft Credit Union Bill; and
- Finally, I will address some lingering concerns of the national credit union movement.

Prudential regulation of the credit union sector by the central bank

Ladies and Gentlemen, many of you would recall that the Cabinet decision in July 2005 to bring credit unions under the regulatory authority of the Central Bank was initially met with disquiet by the credit union movement. This uneasiness, perhaps rightly so at that time, stemmed from the fear that the Central Bank did not really understand the unique character of credit unions and would unfairly treat them just like banks. The fact that the original proposal to bring credit unions under the regulatory authority of the Central Bank envisaged a division of the movement by asset size did little to ease these fears.

I am very pleased to see that we have come a long way over the past decade. The Central Bank is certainly more appreciative and understanding of the special nature of credit unions which value democracy, volunteerism, member equality and participation, member education and training, and community development.

As far as I can judge, today the credit union movement as a whole is strongly supportive of the need for specific legislation that recognizes these special characteristics of credit unions, and supports the rationale behind the Central Bank as prudential regulator of the entire credit union sector. Of course, some are still of the view that increasing the resources and improving the skillsets of the Office of the Commissioner for Co-operatives as well as effecting amendments to the existing Cooperative Societies Act will suffice in regulating the credit union sector.

The fact, however, is that this “light regulatory touch” is usually less effective for those credit unions and their members that need it most. I can assure you that, based on the data available to the Central Bank, several credit unions will have to improve their operations to be in accordance with sound prudential principles espoused by the legislation.

Perhaps the most compelling reason why the Central Bank should be the regulator for credit unions in Trinidad and Tobago is that credit unions are deposit-taking entities. This places a fiduciary responsibility on directors and officers of credit unions to safeguard members’ deposits, and requires that credit unions be subject to a prudential oversight regime. In Trinidad and Tobago, the Central Bank is responsible for this prudential regulation and supervision.

Ladies and Gentlemen, I readily admit that the skills and expertise of the Central Bank’s current pool of supervisors are biased towards regulating banks and insurance companies. In this regard, the Bank has already created a specialized unit within the Financial Institutions Supervision Department to work on development of the credit union legislation and to supervise the financial activities of credit unions. In addition, the Bank will be strengthening its supervisory capacity by recruiting persons with more in-depth knowledge and understanding of the business, governance and risk management practices of credit unions.

As the prime regulatory agency, the Central Bank has a sacred responsibility to ensure that your members can sleep peacefully at nights, secure in the knowledge that their life savings in credit unions are well protected by sound management, effective governance and strong prudential oversight.

Apart from the fiduciary argument, I would like to draw attention to the World Council of Credit Unions (WOCCU), which also makes the case for an agency like the Central Bank to regulate credit unions. In its July 2008 Technical Guide to the regulation and supervision of credit unions, WOCCU maintains that the ministry or agency that regulates financial institutions should also supervise credit unions. WOCCU consistently finds that credit unions supervised by the financial sector regulator enjoy greater public confidence and trust as well as stronger financial performance.

Taking a broader perspective, I must point out that there are economies of scale to having one prudential regulator within a jurisdiction. Such a mega-regulator helps to minimize the risk of regulatory arbitrage and negates the need for coordination of regulation and supervisory actions among multiple regulators. Many of you may recall that this mega-regulator concept is consistent with the 2004 White Paper on Reform of the Financial System in Trinidad and Tobago which envisaged “**a Single Regulatory Authority with the necessary powers and authority for the integrated regulation of the sector**” in Trinidad and Tobago.

Principles underlying the proposed credit union legislation

Ladies and Gentlemen, I now turn to the proposed credit union legislation. At the outset, I must draw your attention to the fact that the Central Bank has engaged extensively with stakeholders on crafting a new, robust regulatory regime for credit unions. These stakeholders include the Ministry of Finance, the Ministry of Labour and Small and Micro Enterprise Development, the Co-operative Credit Union League, the Association of Credit Union Presidents, and members from the credit union movement.

Over the past six years, the Central Bank has issued three Policy Proposal Documents (PPDs) with a view to developing the best possible legislation for the credit union sector. The first PPD was issued in 2006. It served as the basis for initial discussion and consultation with key stakeholders. The second and third PPDs were issued in 2007 and 2009, respectively. These PPDs incorporated a wide range of views from credit unions and other key actors in the credit union sector during consultations. I must mention that these consultations were well attended and stakeholders participated actively, providing relevant comments.

In 2009, the Central Bank formed a committee made up of representatives of the League, the Association of Presidents, the Ministry of Finance and the Commissioner’s Office to finalize the various policy provisions for the Draft Bill as well as amendments to the Cooperative Societies Act.

A Draft Credit Union Bill was sent out for consultation in November 2011. In January 2012, the Bank held information sessions on the Draft Bill with the sector. The Bank is currently reviewing comments and feedback with representatives from the League and the Association of Presidents.

Ladies and Gentlemen, I must indicate that the Draft Credit Union Bill recognizes the co-operative principles, democratic structure, service to members and social goals of credit unions. Permit me to point out some examples of such recognition in the proposed legislation.

- First, the Draft Credit Union Bill recognizes that members are the ultimate decision-making body for the credit union. Appointment of the external auditor, election of fit and proper directors and approval of audited financial statements are made by members at an AGM. As such, credit union members will determine the fitness and

propriety of elected officers and directors and do not require approval of the Central Bank, unlike what obtains for banks and insurance companies. The Central Bank will supervise the work of the boards to ensure that the determination of fitness and propriety is effective.

- Second, the Draft Credit Union Bill recognises that credit unions operate on the principle of volunteerism and the board comprises persons from the membership. As a result, there is no requirement for a quorum of independent directors on the board, as required for banks. Notwithstanding this, the Central Bank encourages boards to supplement its expertise in risk management, financial analysis and compliance, with external advisors, as may be required.
- Third, the Draft Credit Union Bill affirms the democratic principle of “one vote per member”, irrespective of the number of shares held. This, therefore, removes the necessity for provisions to regulate a “controlling shareholder”, as obtains for banks and insurance companies.
- Finally, the Draft Credit Union Bill upholds the principle of “service to members”. As such, credit unions can engage in non-financial activities, up to a limit. Beyond that limit, credit unions can pool their resources with other cooperatives to continue providing these services to their members, on a larger scale.

Differences between the cooperative societies act and the draft credit union bill

Ladies and Gentlemen, there will be fundamental differences in the approach to regulation and supervision between the Commissioner for Cooperative Development and the Central Bank. These fundamental differences are borne out in the legislation. Permit me to point out the relevant ones.

First, the Commissioner is very involved in the operations of the credit union. The Commissioner approves by-laws, individual investment transactions, provision of non-financial services and the use of Reserve Funds. The Central Bank, on the other hand, has placed permitted activities, prohibitions and limits in the Draft Credit Union Bill and regulations. This removed the need for the Inspector of Financial Institutions to engage in the time-consuming task of approving individual transactions and activities for credit unions.

Second, the Cooperative Societies Act is deficient in prudential criteria, governance, enforcement/sanctions and protection of members' funds. The prudential criteria cover capital and borrowing only and require that credit unions must establish 10 percent of their surplus in a Reserve Fund and that a borrowing limit be set annually at an AGM.

By contrast, at the heart of the Draft Credit Union Bill is a regime of prudential criteria covering capital, liquidity, asset quality and earnings, borrowing, credit exposure and non-financial activities. The prudential framework is aligned with the PEARLS financial ratios which have been adopted in the main by the local credit union sector.

Third, the key responsibilities of the board outlined under the Co-operative Societies Act cover preparation of the annual balance sheet, convening and voting at an AGM and election of Board members. By contrast, the Draft Credit Union Bill captures standards for effective governance of the board. It outlines fit and proper criteria for directors, term limits, consideration of multiple directorships, and annual attestation of compliance and fit and proper requirements. It also calls for board approval of all policies, assurance of arms-length basis for all transactions and the establishment of additional Risk and Investments committees to support the work of the board.

Finally, very few offences exist under the Co-operative Societies Act. These include corrupt practice and bribery, falsely obtaining, withholding or misapplying property, and dealing with property subject to a charge. Under the Draft Credit Union Bill, the Central Bank has wider enforcement authority. The Inspector of Financial Institutions may recommend, direct,

suspend or apply for judicial management where a credit union is operating in an unsafe and unsound manner, may be illiquid or insolvent or is in violation of the Act.

Lingering industry concerns

Ladies and Gentlemen, despite the compelling case for regulation of credit unions by the Central Bank and extensive, broad-based stakeholder consultations on the proposed new regulatory regime, some industry concerns still linger.

Most recently, the President of the Credit Union League expressed concerns about what he termed “serious deficiencies” in the proposed legislation and which could stunt the growth of the credit union movement (Guardian Newspaper, February 2013). He listed the following four concerns:

- Restricted term limits for directors;
- Potential conflict between two regulators;
- Non-recognition of the evolution of credit union services beyond “collecting people’s money and loans”; and
- Regime of criminalizing violations in the Credit Union Bill that will hamper volunteerism in the movement

I would like to address each concern in order to dispel, as far as practicable, any lingering fears.

First, in respect of the restricted term limits for directors, I am pleased to announce that the Minister of Finance has agreed to extend the transition period from eighteen months to three years of the Act coming into effect, so as not to cause undue disruption in the governance structure for the credit union sector. In a limited impact study, the Central Bank found that the boards of many of the larger credit unions have directors who would be in excess of the initially proposed term limits, and that compliance could pose severe disruption to the functioning of boards.

Second, in respect of the potential conflict between two regulators it is important to make a distinction between the regulatory role of the Commissioner of Cooperatives and that of the Central Bank. The Commissioner will continue to look after registration, membership, education and training and development of credit unions. The Central Bank will be the prudential regulator with specific emphasis on safety and soundness of credit unions. There is little, if any, potential conflict of interest.

As I indicated earlier, the Commissioner and the Central Bank have worked very closely on the Draft Credit Union Bill and on amendments to the Cooperative Societies Act to make sure that there is no overlap or duplication between these two pieces of legislation. We intend to continue working very closely together in regulation of the credit union sector, each focusing on its regulatory remit and area of competence.

Third, over the past few years, credit unions have, with the approval of the Commissioner for Cooperatives, ventured into non-financial services. These include travel agency services, resorts, gym facilities, daycare services, retail outlets and real estate development. We recognize that these non-core activities provide a supplementary source of earnings for credit unions and provide additional services to the credit union membership. However, these non-core activities represent a potential drain on the limited managerial capacity and expertise of many credit unions. Moreover, these non-financial activities pose risks that are outside the supervisory responsibility of the Central Bank.

As a consequence, the Draft Credit Union Bill allows credit unions to provide these non-financial services subject to certain limits on revenues and assets. These limits seek to ensure that financial intermediation remains the core business of credit unions and that credit

unions can minimize balance sheet risks arising from non-financial activities. In fact, WOCCU recommends “the sum of non-financial investments not exceeding 5 percent of total assets”.

In the event non-financial services grow beyond the proposed limits, the members of the credit union must direct the board to establish a new cooperative, singly or in conjunction with other credit unions, to continue provision of these services. I wish to emphasize that there is no prohibition in the proposed legislation against the credit union and the new cooperative having the same governance structure and composition, an allowance that was requested by the sector.

Finally, the Draft Credit Union Bill makes most violations of the Act or failure to comply with a direction issued by the Bank, a criminal offence, for the credit union and the officer or director. Ladies and Gentlemen, I wish to advise that, in practice, the Inspector of Financial Institutions will first call on the credit union and the officers to fix a problem, by letter of advice, recommendation or compliance direction. In giving a direction, the Inspector follows due process of the law by giving the credit union time to make representation of the cause of the violation and to submit a plan for correction.

I also wish to advise that the Central Bank will not exercise the option to bring the matter before the Court where the credit union opts for the payment of an administrative fine. As such, even though the provision for criminal charges is in the law, it will be used only as a very last resort when all else has failed.

Conclusion

Ladies and Gentlemen, the proposed credit union legislation is an important step towards placing the credit union movement in a position of greater strength, safety and soundness. As we transition to a more robust regulatory regime, the Central Bank is using the time before the passage of new legislation to analyze the audited financial statements of credit unions that have responded to our request for copies of their statements. Over the last year, we have received statements from about 35 credit unions. We will be renewing our request shortly for more credit unions to send us their most recent audited financial statements.

The Central Bank has also been encouraging credit unions to assess the impact of the proposed legislation on their operations and to share such results and any concerns with the Bank. We have had some response from the larger credit unions on the terms of their directors and some smaller credit unions who are members of the League shared their data for calculating the ratios under the prudential criteria. We encourage more credit unions to participate in these exercises which are a valuable means of orientation to the new regime.

Going forward, a key institutional support to the new regulatory framework will be the establishment of a mandatory deposit insurance system for the credit union sector. Not only would the insurance system cover deposits but it must include shares which represent the vast majority of the sector’s savings, a situation that is unique to Trinidad and Tobago. In most jurisdictions, the protection fund for the credit union sector covers deposits only.

We at the Central Bank expect the credit union movement to continue to play a critical financial inclusion role in our financial sector. We feel strongly, however, that more robust regulation and supervision are urgently needed to support further growth and development of credit unions.

In closing, Ladies and Gentlemen, I again thank the board of Telephone Workers’ Credit Union for inviting me to its AGM, and I wish members well in their future contributions to community, the economy and national development.

I thank you.