

## **Jwala Rambarran: Implications of the proposed regulatory regime for credit unions**

Feature address by Mr Jwala Rambarran, Governor of the Central Bank of Trinidad and Tobago, at the 42nd Annual General Meeting of Aero Services Credit Union, Port of Spain, 29 March 2014.

\* \* \*

Ladies and Gentlemen,

It is my honour to be asked by the Board of Directors of Aero Services Credit Union Co-operative Society Limited to address its 42nd Annual General Meeting. I believe this invitation comes at an *opportune* time for the Central Bank to once again reach out directly to the credit union movement, as we move even closer towards regulation of the credit union sector.

It is also my pleasure to speak directly to you, the membership of Aero Services Credit Union. I have known some of your Board Directors for close to a decade and I am aware that Aero Services Credit Union has been responding to the challenges of a harsher socioeconomic climate. I note that, in light of an aging demographic, you have had to expand your membership base outside the aviation industry. Equally impressive is that you have managed to grow your resource base to over TT\$200 million while managing delinquency in a historically low interest rate environment and more competitive financial services sector.

Apart from building wealth for your members, Aero Services Credit Union continues to demonstrate the fundamental values sacred to the credit union movement, a clear indication that you are living up to your motto “the credit union where every dream counts”. You are an example of how credit unions when managed properly can meet their members’ expectations, maintain their trust and confidence, and fulfill your commitment to those who trust you with their hard earned money. 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 fostering greater financial inclusion by reaching out to the ordinary working men and women who are underserved by traditional financial institutions.

Today, about one-third of the population can boast of membership in credit unions. Credit unions have collectively amassed an asset base of over TT\$9.5 billion or 3 percent of the assets of the total financial system assets in Trinidad and Tobago. Your relevance, however, is much richer than your asset base.

Credit unions have helped their members to develop a healthy savings habit, educated them on financial matters and financed small business start-ups, all while experiencing considerable turbulence and consolidation. You have propelled the ideals of financial inclusion as well. These ideals are what you live and breathe every day. So if I may humbly say this, ladies and gentlemen, you do not need the Governor of the Central Bank of Trinidad and Tobago to tell you what your relevance is to the economy of our country.

Accordingly, I would like to take the opportunity this afternoon to speak about issues related to the new proposed regulatory regime for credit unions, which is expected to come into effect in the coming year.

- First, I will highlight why the proposed credit union regulatory regime will benefit your members and the entire credit union movement, paying particular attention to some of the areas of concern highlighted in your President’s Message on Page 7 of your 2013 Annual Report;
- Second, I wish to speak about the proposed establishment of a Protection Fund for credit unions;

- Finally, I will seek to address some lingering concerns of the national credit union movement surrounding the impending credit union legislation.

### **Prudential regulation of the credit union sector**

Ladies and Gentlemen, I now turn to prudential regulation of the Credit Union Sector by the Central Bank.

Before I get into the substance of my address this afternoon and before you start to go into the information overload stage that we all get... let me start with what I like to call the latest and the greatest, that is, the most important point I want to leave you with today, And it is this: *Regulation of the credit union industry will benefit you and it will benefit the people you serve. Regulation is needed and it is coming; embrace it, don't fear it. Regulation will be your best tool for continuing to make every dream count.*

I know by now many of you would be familiar with the Policy Proposal Document for the Credit Union Bill which was done after consultation with stakeholders like yourself. This document is on Central Bank's website and shows you exactly what is the basis for and how the new legislation will work. It is basically a blue print for the entire process.

It tells you for instance the objectives of the Central Bank under the CUA which are:

1. To determine the safety and soundness of credit unions and protect members' deposits and shares from undue loss;
2. To supervise credit unions to determine whether they are in sound financial condition and in compliance with the Act;
3. To maintain confidence in and promote the stability of credit unions and by extension the financial SYSTEM of Trinidad and Tobago.

It is important you understand these three objectives as they explicitly tell you what our intentions are and what we want to accomplish.

Ladies and Gentlemen, back in July 2005, when Cabinet took the decision to bring credit unions under the regulatory authority of the Central Bank, this action was met with grave apprehension 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 regulatory proposal spoke about a division of credit unions by asset size into small and large credit unions (like banks) worsened these fears.

I feel confident almost ten years later the Central Bank is certainly more appreciative and understanding of the special nature of credit unions, especially the co-operative ethos which distinguishes you from any other type of financial institution where usually the most important motive is profit. Many credit unions understand and support the rationale behind the Central Bank as prudential regulator of the entire credit union sector, although it seems that there may still be some low notes against change and regulation.

Some may argue the industry has survived, grown and done very well for itself with a "lite-touch" regulatory approach. However given the events of the last six years you would appreciate operating under the outdated legislation of the Co-operatives Society Act of 1971 cannot continue, as we have seen the enormous impact the failure of one credit union can have on confidence in the entire financial system of the country and how the same people you serve suffer.

Do not see this as the Central Bank clamping down on you, but doing what has to be done to protect our citizens and our economy. I know it will take more convincing than this to persuade those who are against stronger regulatory oversight of credit unions, but I will attempt to show you how regulation will bring clarity to your operations.

First, let me update you on where we have reached with the proposed regulation, the Draft Credit Union Bill.

In recognition of the differences between credit unions and other financial entities that we regulate, the Central Bank has been developing, in consultation with the sector, credit union-specific legislation in the form of a Draft Credit Union Bill (the Bill). These consultations have been extensive beginning in 2006 and ending in July 2013. During that seven-year period, the Central Bank 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 Co-operative Credit Union Presidents, and members from the credit union movement.

During the seven-year consultation period, the Central Bank made several concessions from its original negotiating position in an attempt to reach out to the credit union movement and to narrow, as much as possible, the existing gap between intention and policy. In fact, when I closed consultations last July, I made several concessions on our negotiating positions in the spirit of compromise and consensus building. By my count, the Central Bank made more than ten substantial concessions spanning governance, prudential requirements, non-financial services and penalties affecting credit unions.

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. In developing the legislation, the Central Bank considered it important that many of the current services and practices of credit unions be maintained. However, we also considered it absolutely necessary that relevant and appropriate prudential limits be put in place and enhancements made for more effective governance. In these two areas of governance and prudential limits, we did not accept several suggestions made by the sector, as they were not consistent with the desired safety and soundness objectives of the credit union legislation.

### **Governance requirements**

The Draft Credit Union Bill recognizes that members are the ultimate decision-making body for the credit union. The Bill contains provisions for proper governance and effective risk management in order to ensure the safety and soundness of credit unions. Credit unions that are sound can best meet the needs of their members, including providing financial services, training members in entrepreneurship and in financial literacy.

Governance proposals seek to ensure that the directors of a credit union are fit and proper and that the board is effective, accountable and transparent in the management of their credit union. As far as fit and proper goes, the proposed legislation seeks to establish minimum qualifications for Board Directors. The Bill requires that Board Directors who do not meet the minimum qualification requirements would have to obtain relevant training within a reasonable period of 18 months of becoming a Director. Today's dynamic financial environment requires persons who are knowledgeable, who understand the complex products being offered as investments, and who can guide the credit union based on an understanding of the environment and the changes taking place.

### **Prudential criteria requirements**

In addition to strong governance, there must be standards, limits and prohibitions which guide the financial management and operations of the credit union to ensure its financial soundness. The Bill seeks to introduce prudential requirements aimed at strengthening the balance sheet and managing risk exposures faced by credit unions.

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.

I would like to draw your attention to the minimum capital requirement, which is one of the concessions made by the Central Bank. As you can well appreciate, adequate capital is essential to finance all non-income generating assets of your credit union. Capital is also used to absorb losses from loan delinquency or operating deficits. The proposed legislation requires a credit union to have a minimum capital of 8 percent of total assets, reduced from 10 percent in the original proposal. In addition, a credit union with capital below the minimum (at the time the legislation is passed) must submit a plan to the Central Bank to meet the capital requirement in three years, if it wants to make dividend payments.

I would also like to draw your attention to the liquid funds ratio, which is another important prudential requirement that must be maintained in order to enable a credit union to meet the day-to-day demands by members for withdrawal of their funds and to ensure that the credit union remains liquid. A lack of liquidity can negatively affect a credit union given that the first time someone is unable to access their shares or deposits this sends negative signals and may lead to a run on the credit union. Liquidity is therefore critical to the confidence members have in a credit union and its continued viability.

I hope you will forgive me if I sound a bit technical but I believe it is important to cover some of these points as I seek to convince you that while for some the devil is in the details, for you, it will be the angel in the details.

### ***Establishment of protection fund for deposits and shares held in a credit union.***

Ladies and Gentlemen, I now turn to the establishment of a Protection Fund for credit unions.

A key institutional support to the new regulatory framework is the establishment of a mandatory deposit insurance system to protect credit union members and, by extension, to enhance stability of the financial sector. The Protection Fund would be managed by the Deposit Insurance Corporation. Not only would the Protection Fund cover deposits but it would include withdrawable shares, that is, shares not held as permanent shares which represent most of the sector's savings, a situation that is unique to Trinidad and Tobago. Withdrawable shares, therefore, pose a greater loss of risk than deposits for credit union members in the event of a credit union's failure.

In January 2014, the Central Bank disseminated its Consultation Paper on the "Protection Fund for Deposits and Shares Held in Credit Unions" to the credit union sector for comments. The key elements of the proposed Protection Fund are the following:

- All credit unions that have an Operating Certificate granted by the Central Bank will be eligible to join the Protection Fund, except if in they are liquidation;
- Initial seed funding will be made by the credit union sector (and possibly by the Central Bank and the government). Sound funding is critical as it is quite possible that there may be immediate claims on the Protection Fund;
- The Protection Fund is expected to be established one year after the enactment of the CUA; and
- The Protection Fund will cover deposits and withdrawable shares in the total amount of \$125,000, of which \$75,000 will apply to deposits and \$50,000 to shares, subject to the number of accounts.

Initial feedback relating to the introduction of the Protection Fund surrounds the decision by the Central Bank to use to the DIC to administer the Fund and not the existing Trinidad and Tobago Credit Union Deposit Insurance Fund (TTCUDIF), formerly known as the "Stabilization Fund". There are at least three reasons why the Central Bank chose the DIC as the administrator and not the Stabilization Fund.

These are as follows:

- First, membership in the Protection Fund will be mandatory for all credit unions. Membership is voluntary in the Stabilization Fund, which is a co-operative.
- Second, there are economies of scale to using the DIC. It has the track record, infrastructure and requisite expertise from over twenty five years of managing a similar protection fund for the banks and non-banks.
- Finally, the DIC stands as an entity with its own statute governing its administration and functioning and is therefore independent of the credit union sector.

### **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.

I would like to address the following three concerns:

- 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.

First, in respect of the potential conflict between two regulators it is important to make a clear 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.

Second, and this is indeed a very important point to note as it touches on many real life and existing circumstances and in the case of the most recent and largest failure of a credit union to date, was one of the reasons their members and depositors suffered.

Over the past few years, many 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 Credit Union Bill allows credit unions to provide these non-financial services once they represent no more than 5 percent of total assets or 10 percent of revenues. These limits seek to ensure that financial intermediation remains the core business of credit unions and credit unions can minimize balance sheet risks arising from non-financial activities.

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 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 either letter of advice, recommendation or compliance direction. In giving a direction, the Inspector follows due process of the law by giving the credit union enough 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**

In closing, 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. The Credit Union Bill is now before the Legislative Review Committee of Cabinet. The Committee has indicated that it would like to have sight of the findings of the Colman Report of the Commission of Inquiry before it proceeds to the next stage.

Credit unions are urged to embrace the proposed prudential legislation and work towards realigning their thinking towards prudential regulation, understanding how the decisions they make affect their balance sheets and ultimately the welfare of their members. The current economic environment is conducive to growth and expansion and for a sector that has so much potential you should aspire to take advantage of this potential by putting your financial houses in order and setting a course for the future in a more tightly regulated framework.

I again thank the Board of Aero Services 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.