Loi M Bakani: The future of credit unions given the global regulatory trends

Speech by Mr Loi M Bakani, Governor of the Bank of Papua New Guinea, at the Pacific Credit Union Technical Congress 2014, Port Moresby, 6 November 2014.

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1. Acknowledgements

Members of the OCCUL Board

Board Members of Credit Unions in Pacific

Distinguished Guest Speakers

Congress Delegates

Ladies and Gentlemen

2. Introductory remarks

Let me begin by thanking OCCUL for inviting me to speak at this Congress on *"The Future of Credit Unions given the Global Regulatory Trends"*, from my perspective as the Governor of a Central Bank in the Pacific Region and Registrar of Savings & Loan Societies in PNG.

I suppose the greatest strength for the credit union movement lies in the model it is built upon which is based on the interdependence and mutual support by each other, the members. Credit unions are all about financial inclusion. They provide services to their members who may be part of the working class, civil servants, or community based. Credit unions provide services for small savers, big savers, small borrowers and big borrowers alike.

Even though our credit unions in the Pacific vary significantly from country to country, in terms of the level of development, or maturity they are at and the applicable rulebooks, the challenges faced by practitioners and for Regulators are similar.

Secondly, credit unions provide competition in the financial intermediation market and are some of the major players in the Pacific region too. The credit union movement will have to continue changing with the times to meet its members' needs, to fend off competition, from other financial service providers to survive in a very competitive industry and environment.

Competition has its benefits. It forces the credit unions to be managed professionally and diversify and improve on the services it provides to its members. Credit unions are another tier of financial institutions providing financial services like any other tiers of financial service providers. The products and services depend on how credit unions are structured in each jurisdiction. Some operate almost like small commercial banks in a competitive environment, while others remain small, concentrating on fewer basic services for its membership. The sustainability of the credit union movement requires that credit unions get into increasingly riskier activities to survive in a highly competitive industry. In these circumstances, formal rigorous supervision will become more critical.

From our experience, credit unions or savings & loan societies as they are referred to in Papua New Guinea (PNG), are increasingly aware of their own challenges and are taking measures to maintain their positions or space in the market. However, to do this, societies continue to seek the Registrar's endorsement to venture into these risky activities. We wanted to do away with that and therefore have proposed some legislative reforms to give boards and management more opportunities and decision making in operation of their institutions.

3. Increased regulatory compliance

In discussing the benefits of credit unions, I am mindful of the increasing need for regulatory compliance globally and we in the Pacific are no different. Ladies and gentlemen, I know you will agree with me that credit unions have evolved over time. There has been a lot of growth in the movement in terms of membership, the growth in asset size and how credit unions do business (refer booklet by OCCUL). We cannot allow the movement to be stagnant, it has to be guided to adapt to global and domestically driven changes. In doing so, legislative reforms have to be made to enable appropriate and relevant regulation and supervision by the Regulator. As we all know, the high demand for regulatory compliance increases costs. This is inevitable but one that should be balanced. Increase in regulation can be due to a number of reasons:

- A policy change by government or the standard setters.
- Effects of globalisation, for example the Global Financial Crisis.
- Technological innovation is becoming the order of business operations today and if credit unions are to survive, reforms should be encouraged to enable changes and enhancements to be made. Technology is changing the landscape of the way business conduct themselves. For us in the Pacific, the population is scattered throughout many small islands and into the rural communities, which makes provision of financial services and accessibility for these services very costly. Technology like the use of mobile phones by credit unions will enable availability and accessibility of services to reach the rural majorities.
- Thirdly, there is increasing trade across borders made possible by technological innovation and whilst it is good, it has its own risks such as money laundering, terrorism financing and scams. Thus, regulation must be appropriate to govern them.
- Questionable practices by those entrusted with the duty to manage credit unions resulting in enacting rules to correct those practices. Topical issues today include financial corruption, insider trading, and conflicts of interest.

4. Global regulatory trends

Ladies and gentlemen, the credit union sector in the Pacific plays a crucial role in helping to meet financial, economic and social needs of our people. However since we are part of a global village, whatever happens in the World economy affects how we do business in the Pacific. This was seen clearly by the recent global financial and economic crisis which prompted governments to come up with new laws and rules to safe guard banks and financial institutions from systemic risks.

At this point let's discuss some issues relating to the global regulatory trends.

The World Council of Credit Union (WOCCU) 2013 Annual Report, highlighted the following four issues as key challenges to the credit union movement, which are: 1. *Increased regulatory burden;* 2. *Payments innovation;* 3. *Young adult membership growth;* and 4. *Small credit union sustainability. Those of you who attended the World Credit Union Congress in Gold Coast may remember these issues being discussed.*

Firstly, I see these challenges as the key areas that are driving the regulatory trend. Since the global financial crisis, governments around the World have tried to push for credit unions to come under close scrutiny and regulation, which is good for the credit union credibility but can damage the movement. For example, pushing smaller credit unions, to report as per the International Financial Reporting Standards (IFRS) for credit instrument impairment and BASEL III Requirements. This goes also for AML compliance. Whist they are appropriate for bigger banks, they may not be for credit unions because the credit unions are established to promote thrifts and provide access to credit for provident purposes and are an alternative to the banks and financial institutions. Therefore, it is becoming increasingly difficult for credit unions to serve their members when such laws and regulations are ignoring the business structure and size difference between credit unions and banks.

However, if the regulation is streamlined to a model conducive for credit unions to grow, regulation of the sector will be beneficial in the long term.

In PNG, we have taken the initiative to review the Savings & Loans Society Act in close consultation and input from the industry. The review of the draft S&L legislation has been completed in 2013 and has now progressed to Parliament to be finalised and passed as law. It is our wish that the new legislation will assist the industry to grow and allow for the expansion of societies/credit unions in the long term.

We must be committed to enhancing the credit union movement as much as possible particularly with regard to business lending and raising of capital, but at the same time we also need greater flexibility in order to serve our members.

Secondly, another trend the credit unions worldwide are embarking on is *to address payments innovation*, where credit unions venture into partnerships with private sector to improve their payment systems. As experienced in PNG, some societies have been able to build shared mobile phone technology platforms to provide the underserved members with access to their accounts and other financial services provided by the society through mobile banking products. The PNG financial institutions & credit unions have teamed up with mobile network operators such as Digicel to extend their services to the rural areas where banking services are not available and thus fulfilling the financial inclusion mandate.

Thirdly, we also see a trend in *addressing membership growth* of financial institutions & credit unions through networking workshops, educational awareness and financial inclusion expositions that are been conducted to disseminate information, open new accounts, conduct awareness and share best practices. These new innovative products & services offered are effectively reaching potential unbanked members through mobile phone technology, marketing outreach, financial literacy and social media advertising. In PNG, savings & loan societies have signed up and partnered with the mobile service providers & the Microfinance Expansion Project funded by the Government and donor organisations to open up new savings accounts and promote best practises in the use of these products.

Fourthly, to ensure sustainability of smaller credit unions; Credit unions & financial institutions are being challenged continuously by regulatory burden, to improve or acquire cost effective management information systems and membership growth. This dictates the use of systems that are capable to assist and sustain its operations. Therefore credit unions have engaged with system developers to discuss collaborative solutions such as shared back office systems and payments platforms etc. The lessons learnt from such arrangements have allowed other collaborative networks that can improve small credit union efficiency and allow them to offer the full range of products that consumers demand. In PNG FESALOS facilitates the ULTRA DATA 3 that is used by member societies to run their operations.

5. The future of credit unions

Our industry landscape may continue to change every year, but our common mission and values continued to resonate with consumers. Across our global community, we find a variety of modern tools and methods to respond to our common challenges. When we collaborate, we have the power to share innovative ideas and strategies that help strengthen the future of the credit union movement.

We all know that the global financial crisis created a need to develop an industry model that would pave the way towards success for the movement in the Pacific. This has also brought with it a need for banks and financial institutions to be more closely regulated and in turn increasing the costs of compliance. Currently there is inefficiency in capacities of the regulator to properly regulate while on the other hand the credit unions often lack the capacity to comply. The industry needs a model tailored to its needs; one that encourages expansion and allows consolidation where appropriate to increase services to the members under economies of scale.

We have seen in the last five (5) years a number of countries have undertaken major reforms in legislation of credit unions. I understand this is the same in the Pacific. Times have changed, and we have to model these changes or else our industry will be left behind.

Reforms must be appropriate and relevant to the challenges facing the movement. Any legislative reforms governing credit unions and societies in the Pacific should aim at promoting growth and development in the industry and not stifle it. As our governments, various regional groups and donors focus increasingly on regional/Pacific cooperation and trade, this may provide an opportunity for the CU movement in the Pacific to consider ways to expand and sustain itself in future.

Credit unions are here to stay. Its sustainability depends very much on each of us here today in ensuring:

- ***Systems of Good & Strong Governance*** is in place to ensure accountability at all levels, from management through to the board. Our members should feel comfortable that their savings are safe and that they will continue to have access to them and other services provided by the society;
- ***Fit & Proper Persons*** – having the right people in management and the board is critical to the success of credit unions who will drive the credit unions forward;
- ***Training*** for staff, management and the board is also critical and should form part of the credit union yearly plans. Do not downplay the importance of training. If you want good returns and provision of quality services to members, then training should be given the importance it deserves.
- ***Adequate Risk Management Framework*** must be in place. Your understanding of this area is a must. If you understand, you will work to ensure it is in place. If you don't, then you could be a risk to the entity.
- ***Suitable Products for Members*** – ensuring that products being developed are suitable for your members. Credit unions should not be wasting their resources on developing products that are not suited for the members.
- ***Member Protection and Awareness*** – needed to ensure satisfaction, confidence and sustainability of the industry. Our members, like any consumers demand protection from improper practices in service delivery, want fair and competitive service at appropriate cost to them. CUs need to focus on their members welfare in regard to services they can access.

6. Conclusion

To conclude, I have highlighted that given the ever changing global, regional and domestic economic and financial environment, the complexity of the financial system, products, transactions and structures, the complexity of demands by consumers and membership of CUs, there is now a common trend for increased regulation and supervision. Coupled with increased competition that CUs have to tussle with, other issues like money laundering, terrorism financing, financial corruption and scams have reached the forefront of regulators. Making reforms to legislations and regulation are necessary. But the capacity for regulators to regulate, and for CUs to comply with them is an ongoing challenge. Finding the balance between the two, and the appropriate model for the CU movement is always the challenge for regulators.

Some of you participants will be graduating tomorrow under MCP, and I hope that you are already using the new knowledge to meaningfully contribute to the operation of your respective credit unions and thus the movement as a whole. If you have not started, start as soon as you go back and make a difference. The knowledge you have acquired is not for you to keep but to use it.

I congratulate you for your achievements and wish you all the success in implementing these lessons in your institutions.

I wish OCCUL all the success in hosting this event.

Thank you for listening & God Bless.