Ed Sibley: Report on Local Public Banking and work of Central Bank of Ireland

Introductory statement by Mr Ed Sibley, Deputy Governor (Prudential Regulation) of the Central Bank of Ireland, at the Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach (Head of Parliament), Dublin, 23 October 2018.

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Good afternoon Chairman, Committee Members.

Thank you for the invitation to appear today to discuss the recent Report on Local Public Banking in Ireland[1] (the report) and related matters. I am joined today by Patrick Casey, the Registrar of Credit Unions, and Anna Marie Finnegan, Head of Policy, Registry of Credit Unions.

In my brief remarks today, I will address three topics that intersect between the scope of the report and the work of the Central Bank of Ireland (Central Bank). Firstly, I will provide an overview of the process for bank authorisation; secondly, I will outline developments in the provision of credit to the SME sector in Ireland; and thirdly, I will discuss the regulation and supervision of the Credit Union sector.

1.Authorisation

Since the commencement of the Single Supervisory Mechanism (SSM) in late 2014, the European Central Bank (ECB) has been the competent authority for the authorisation of banks in Ireland and across the Eurozone. This means that applications for bank authorisation are dealt with in a consistent manner across the entire Eurozone.

In practical terms, the local national competent authority (i.e. the Central Bank of Ireland for Ireland) assesses applications in consultation with the ECB, prior to a recommendation being made through the SSM's governance processes on whether to approve the application or not. To this end, the Central Bank has dedicated authorisation teams following processes that are transparent, predictable and consistent.

The assessment of an application will consider, inter alia: the financial resources the firm has available (including under a plausible stress); the sustainability of its business model; governance and risk management arrangements; and its ability to recover if it gets into difficulty. Applicants that can meet the requisite standards in these areas will be approved.

2.Provision of credit to the SME sector in Ireland

The Central Bank understands the importance of SMEs to the Irish economy. SMEs account for the vast majority of active enterprises by number and employ about two thirds of the Irish workforce.[2]

In Ireland, the majority of SME investment is financed through internal funds.[3] For external financing, bank lending and leasing are the two largest sources of funds.[4] Recognising the challenges faced by the SME sector, the Central Bank has issued regulations that aim to strengthen protections while also facilitating access to credit, by introducing specific requirements that regulated lenders must comply with.[5]

The provision of credit to SMEs in Ireland was undoubtedly severely affected by the financial crisis. Default rates remain elevated, the most recent SME market report shows default rates across all sectors are on average 22.6%.[6] The total credit outstanding to non-financial, non-real estate SMEs stands at €16.2 billion in Q1 2018.[7] Today, the provision of bank credit to SMEs in

Ireland is very concentrated. Three banks had an 87% market share of all new SME loans issued in the first quarter, 2018.[8] This concentration, together with the higher historic levels of default in Irish SME lending are contributory factors in interest rates for Irish SMEs being higher than average interest rates for SMEs operating in other countries in the Eurozone.[9]

Nonetheless, there have been improvements in the provision of Irish SME credit in recent years. Annualised new bank lending to non-financial, non-real-estate SMEs has risen from €2bn in late 2013 to €3.75bn as of the first quarter of this year.[10] This recovery has been broad-based across industrial sectors, but two sectors are predominant: the agricultural and

Wholesale, Retail Trade and Repairs sectors account for 42% of the new bank lending.[11]

Overall, as reported in the Department of Finance SME Credit Demand Survey, the credit market has shown a reduction in the application rate for bank financing from March 2012 to March 2017 but has since stabilised and increased moderately in the period to March 2018.[12] Demand for financing is most common among medium size firms and lowest among micro sized firms (those with less than 10 employees). The rejection rates shows a steady decline from March 2012 to March 2016 and have stabilised in 2017 and 2018. The survey also shows micro firms experience significantly higher rejection rates than other SME types.[13]

The range of funding available to the SME sector has expanded in recent years. The establishment of the Strategic Banking Corporation of Ireland (SBCI) has provided a further source of funding to Irish SMEs. Total SBCI loans drawn down from inception to end-March 2018 stood at €952 million.[14] A range of asset-based financing firms, peer-to-peer lenders, invoice discounters, leasing firms and other types of non-bank financiers have entered the domestic market in recent years and provide a significant potential alternative source of financing for SMEs.

3.Credit Union Sector

Credit unions play an important role in Irish society and in the financial system. The role and ethos of the sector reflect the primary objectives and purpose of credit unions - to promote thrift among their members by the accumulation of their savings and the creation of sources of credit for members' mutual benefit at fair and reasonable interest rates. Our role in relation to credit unions is reflected in our statutory mandate to regulate with a view to ensuring the protection by each credit union of the funds of its members and the maintenance of the financial stability and well-being of the sector.

The Central Bank is supportive of further development of Credit Union business models. The consolidation and strengthening of the sector has seen improved standards in the running of credit unions and their financial resources but further progress is required on embedding governance, risk management and operational capability. The emergence of larger and more sophisticated credit unions presents additional opportunities.

Credit unions are already permitted to provide “commercial” loans but are not currently particularly active in this type of lending. The Central Bank will shortly be consulting on proposed changes to the lending framework for credit unions. The proposed revisions also provide increased capacity to engage in both home mortgages and commercial lending for those credit unions with the financial strength, competence and capability to do so.

Should credit unions wish to become involved in a local public banking model, they will need to ensure the continued protection of members’ funds and comply with the legislative and regulatory framework[15] that applies to credit unions.

I hope the above has been useful in terms of the topics that the Committee wishes to discuss.

[1] Department of Finance and Department of Rural and Community Development Report on Local Banking available here.

[2] For further information on the role of the SME sector in the Irish Economy. see Address by Philip R. Lane, Governor of the Central Bank of Ireland, at the Irish Small and Medium Enterprises Association Annual Conference 2016, Royal Dublin Society Available here.

[3] See Carroll, James et al (2016) Irish SME Investment in Economic Recovery. In Central Bank of Ireland Quarterly Bulletin 02, April 2016. Available here.

[4] See footnote (iii) page 88.

[5] See Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Lending to Small and Medium Size Enterprises) Regulations 2015. Available here.

[6] See SME Market Report 2018. Available here.

[7] See footnote (vii) page 1.

[8] See footnote (vii) page 1.

[9] See footnote (vii) page 18. Figure 29.

[10] See footnote (vii) page 2. Figure 1.

[11] See footnote (vii) page 2. Figure 2. The Wholesale, Retail Trade and Repairs sectors includes businesses such as cash and carry wholesalers, all retail shops and also includes car sales.

[12] See Department of Finance SME Credit – Demand Survey October 2017 – March 2018 page 1. Available here.

[13] See footnote (xiii) page 59.

[14] See Strategic Bank Corporation of Ireland, 2018 progress update. Available here.

[15] The Credit Union Act, 1997 ('the 1997 Act') and the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 ('2016 Regulations') set out the services that a Credit Union may provide to its members and the investments that a Credit Union may undertake with members' funds taking account of the overriding requirement not to put members savings at undue risk.