



HM TREASURY

Review of the legislative framework for the credit unions and industrial and provident societies in Northern Ireland

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1

Review of the legislative framework for credit unions and industrial and provident societies in Northern Ireland

Introduction

1.1 The Treasury announced in the 2008 pre-Budget Report that it would review the legislative framework for credit unions and industrial and provident societies (IPSS) in Northern Ireland (NI), working closely with the Northern Ireland Executive. The terms of reference are set out in Annex A.

Conduct of the review

1.2 The Review team consulted major stakeholders in NI (see Annex C) and undertook a desk review of the legislative and regulatory framework governing IPSS and credit unions in both Great Britain (GB) and NI as well as considering the powers and regulatory frameworks applying to credit unions in other jurisdictions. The Review team is grateful to stakeholders for taking the time to share their views and expertise.

Summary

1.3 Credit unions have been important contributors to social and economic development since they first appeared in Europe in the 1830s. They play an increasing role as financial services providers, particularly to those on lower incomes. Across the world, credit unions are increasingly being integrated into mainstream financial services regulation, and given greater freedom to offer services to their members and communities. Annex F illustrates some initiatives worldwide.

1.4 Compared with their counterparts in GB and the Republic of Ireland (RoI), NI credit unions have limited opportunities to provide a wide range of services, this despite the fact that half the adult population of NI belongs to a credit union, compared just over 1% per cent in GB. Access to compensation in the event of failure is also patchy in NI, with some credit union members having no protection at all.

1.5 Against this background, the review recommends that the Government together with the Assembly should consult on bringing NI credit unions within the scope of Financial Services Authority (FSA) regulation, while leaving the legislative and registration functions with the Northern Ireland Assembly and the Department of Enterprise, Trade and Investment Northern Ireland (DETINI). This would bring certainty on compensation arrangements to NI credit unions members, while giving the NI Assembly continuing freedom to respond to the distinctive nature of credit unions in NI.

1.6 By contrast, the IPS sector in NI is relatively small. The particular concerns surrounding the collapse of the Presbyterian Mutual Society (PMS), which went into administration in November 2008, do not appear to apply to other IPSs.

1.7 The review nevertheless considers that there is scope to improve the governance of IPSs, in particular, to reduce the risk that members misunderstand the nature of their investment. It therefore recommends that the NI authorities should consider what could be done to improve the NI legislation governing IPSs, with the aim of improving member information and governance.

1.8 In the case of consumer education, the review notes that credit unions are already active in NI, and that regulation by the FSA would expand the opportunities for financial education through participation in Government schemes like the Child Trust Fund and Saving Gateway.

2

Background

2.1 The registration and regulation of credit unions and the registration of IPSs¹ are subject to different legislative regimes in NI and GB. This has an impact on the services that can be offered in each jurisdiction, as well as access to compensation in the event of failure.

2.2 Under the Financial Services and Markets Act 2000 (FSMA), the regulation of financial services is reserved to the FSA, unless a specific exemption has been granted. To carry on a regulated activity a permission under Part IV of FSMA is required.

2.3 Credit unions in NI, and IPSs across the UK, are exempt from FSA regulation for accepting deposits².

Credit unions

Credit unions in Northern Ireland

2.4 Credit unions in NI date back to the early 1960s. There are 181 credit unions, with over 400,000 members, serving 50% of the adult population. In 2006, total assets were £820 million. The two main trade bodies for the sector are the Irish League of Credit Unions and the Ulster Federation of Credit Unions.

Table 2.A: Profile of the Credit union movement in Northern Ireland

Affiliation	Credit unions	Members	Shares (Savings)	Loans	Net assets
ICLU	104	350,000	£627m	£430m	£737m
UFCU	51	23,000	£24m	£11m	£28m
Tyrone Federation	13	10,000	£23m	£8m	£25m
Other	13	25,000	£26m	£19m	£30m
Total	184	408,000	£700m	£468m	£820m

Source: 2006-07 Annual Returns to DETINI Registrar

2.5 Credit unions in NI are registered under the Industrial and Provident Societies Act (Northern Ireland) 1969 and the Credit Unions (Northern Ireland) Order 1985. The 1969 Act consolidated the provisions of previous legislation dealing with IPSs and applied those provisions with suitable modifications to credit unions, which were recognised in the Act as a special category of society. The legislative regime for credit unions in Northern Ireland is now set out in the 1985 Order.

2.6 Credit unions may provide basic savings and loan services within the limits set out in the 1985 Order. These limits include the size of deposits for those under 16 years of age, dividends

¹ IPSs in NI and GB are not broadly subject to formal regulation any more than companies, unless they are providing regulated financial services.

² The Financial Services and Markets Act 2000 (Exemption) Order 2001 - SI 2001/1201 as amended by SI 2001/3623. With some limited exceptions, deposits in NI credit unions are in the form of shares.

payable, the amount of loan advances and the percentage of loan interest rates chargeable. These amounts may be amended by Order made by DETINI.

Credit unions in GB

2.7 There are 532 credit unions in GB, with a total of 675,789 members and over £500 million in assets³.

2.8 The GB legislative framework generally offers greater flexibility to credit unions than the NI equivalent. In GB credit unions are established under the Credit Unions Act 1979 and the Industrial and Provident Societies Act 1965. The FSA acts as both registrar and regulator for the sector, and credit unions are required to obtain permission under Part IV of FSMA before taking deposits. They are subject to their own specialist regime and regulatory Handbook (CRED).

2.9 The GB legislation has been subject to a number of reforms in recent years, first to enable regulation by the FSA, and subsequently to amend the requirements for the membership qualification; clarify the circumstances under which the term credit union may be used; and allow credit unions to charge for the cost of providing ancillary services⁴.

2.10 The Government carried out a wide-ranging review of GB IPS and credit union legislation in 2007. A number of measures resulting from this consultation are being taken forward through a Legislative Reform Order and Government support for a private members Bill. These include relaxing the membership qualification for credit unions, both widening scope and allowing corporate membership; and other measures to enable credit unions to carry out their business more flexibly.⁵

Impact of current regime on provision of services in NI credit unions

2.11 The table below sets out some of the effects on NI credit unions of being exempt from FSA regulation as deposit takers. Any NI credit union undertaking a regulated activity, in addition to deposit taking, would lose the current FSMA exemption and be required to seek authorisation for all regulated activities. Thus the ability of NI credit unions to offer additional financial services is constrained. In addition, the lack of access to the Financial Services Compensation Scheme has acted as a barrier to NI credit unions having access to government initiatives such as the Growth Fund, which provides funding for onward lending. The Republic of Ireland (RoI) has a legislative and regulatory regime that is similar to that in GB, and hence credit unions there are able to offer a wider range of services.

Table 2.B: Comparison of the services provided by credit unions in NI, GB and ROI

Activity	NI	GB	RoI
Deposit takings	Y (exempt from FSA regulation)	Y	Y
Current accounts	N	Y (indirectly under an arrangement with the Cooperative Bank)	Y
Insurance services	N	Y	Y
Transfer of securities	N	Y	Y
Access to Government funding	N	Y (Growth Fund)	N

³ http://www.fsa.gov.uk/smallfirms/resources/factsheets/pdfs/creditunionstats_06.pdf
⁴ Regulatory Reform (Credit Unions) Order 2003 – SI 2003/256
⁵ See "Review of the GB cooperative and credit union legislation: a consultation" June 2007 and "Proposals for a legislative reform order for credit unions and industrial and provident societies in Great Britain" July 2008 and 14th of April 2009. http://www.hm-treasury.gov.uk/consult_credit_union.htm

Group/Society membership	N	Planned as part of current reforms	Y
Participation in Government savings initiatives	N	Y (ISAs, CTF, Savings Gateway)	Y
Corporation tax on income	Y	Y	N

Compensation arrangements

2.12 In GB, regulation by the FSA means that credit unions are required to contribute to the Financial Services Compensation Scheme (FSCS) and the Financial Ombudsman (FOS) (Worked examples of the possible costs are provided in the table at page 16). The FSCS provides for up to £50,000 protection of savings per member, in the event of a credit union failing.

2.13 Although they do not have access to the FSCS and FOS, a majority of NI credit unions belong to voluntary schemes, which protect members' deposits to some degree in the event of failure.

2.14 A total of 104 credit unions belong to the Irish League of Credit Unions. The ILCU scheme provides stabilisation funding to rescue failing credit unions and as a last resort would pay out directly to members of the credit union. The introduction of the state scheme in the Republic of Ireland guarantees each credit union member's savings up to a maximum of €100,000, but this does not apply to ILCU members in Northern Ireland.

2.15 The ILCU has a long history of supporting credit union development and best practice and prior to the change in financial services regulation in recent years worked with the regulators, in both NI and the RoI, to help provide data for regulatory purposes. It is not clear what the full impact will be of the Irish government taking on responsibility for consumer protection for credit union members as well as bank customers and how this might affect ILCU members in Northern Ireland. The Irish League have indicated that there is unlikely to be any change in the short term and that the final outcome may well depend on how the issues of legislation and regulation for NI credit unions are resolved.

2.16 51 credit unions are affiliated to the Ulster Federation of Credit Unions (UFCU), which has a scheme that is funded by each credit union at the rate of 1% of shareholding; maintaining a reserve that will pay 80 pence in the pound in the event of a credit union failing. So far this particular scheme is untested. The remaining 26 smaller credit unions have no cover at all.

2.17 The NI credit union sector is generally robust and there have been no failures since 2001, which compares with over 30 failures amongst GB credit unions over the same period. The global financial crisis will have an adverse effect on all financial institutions, but there is no evidence to suggest that this uncertain environment has weakened the credit union sector in NI.

Financial Education

2.18 Credit unions in both NI and GB demonstrate a continuing commitment to financial education, particularly in schools and for lower income groups. With the much higher market penetration in NI, reaching 50% of the eligible adult population, there is a commensurately greater opportunity to help local communities. A much lower market penetration by credit unions in GB, reaching only about 1% of the population means the opportunities are more restricted. Nevertheless, recent research suggests that 91% of credit unions in GB regard

financial education as important to their credit union and over two thirds have partnerships with schools⁶.

2.19 ABCUL and the Credit Union Foundation are also working with GB retailers to develop a community-based project to enhance financial understanding and capability amongst children and young people. Two credit unions in North West England are taking part in the ‘Moneymadeclear’ Pathfinder, a joint Government/FSA pilot for a national money guidance service.

2.20 The exclusion of NI credit unions from government schemes such as the Child Trust Fund (CTF) and Growth Fund places limits on opportunities for linking with financial education. The CTF helps to encourage a savings culture and presents a practical opportunity for practical financial education. NI has the lowest active account-opening rate in the UK: this may be influenced by the lack of credit union participation in education. In their submission to the ETI inquiry the Council for the Curriculum, Examinations and Assessment (CCEA) recognised how effective financial education schemes can help people manage their money and they have worked with a small number of credit unions, for example, Derry credit union which provides financial education through meetings, as well as involvement with community groups and schools.

2.21 Both UFCU and ILCU have helped the FSA to develop financial education in NI. The FSA funds development officers based at the CCEA, working with 15 primary and 15 secondary schools. It also works in higher and further education, for example, the ‘Money Doctors’ project equips students’ money advisers and the Money for Life initiative is being taken forward with staff in NI further education colleges. It is likely that the inclusion of NI credit unions in the FSA regulation and access to the FSCS would enhance the role of credit unions in NI in financial education and as well as complementing the FSA’s financial capability role.

INDUSTRIAL AND PROVIDENT SOCIETIES

2.22 The IPS sector in NI is fairly small, consisting of 84 societies in 2007. The concentration is in agriculture and housing associations, with one IPS (also registered as a charity), being a community investment trust providing support to the social economy throughout Ireland. This operates in a similar way to Community Development Finance Institutions (CDFIs) in GB.

Table 2.C: Industrial and provident Societies in NI

Type of Society	Number of Societies	Membership	Assets (£000) ⁷
General Supply Cooperatives	1	7	2,500
Agricultural Societies	29	16,300	70,500
Housing Associations	37	4,000	422,800
Miscellaneous Societies	17	3,400	335,900

Source:

2.23 The legislation governing the registration of IPSs is the Industrial and Provident Societies Act (Northern Ireland) 1969, as amended by the Industrial and Provident Societies (Amendment) (Northern Ireland) Order 1976 and the Industrial and Provident Societies (Northern Ireland)

⁶ “Breaking through to the future” The strategic development of credit unions in Britain, 1998 – 2008 - Paul A Jones, Research Unit for Financial Inclusion, Liverpool John Moores University In collaboration with the Association of British Credit Unions Ltd.

⁷ Source: Registry of Credit Unions and Industrial and Provident Societies, Annual Report 2007-08 (NIA 38/08 - 09)

Order 2006⁸. It should be noted that in the case of housing associations in Northern Ireland, which are regulated by the Department for Social Development, there is no exemption from regulation in respect of the provision of mortgage services, as there is in GB⁹. Whilst no housing association in NI currently undertakes such regulated services, should they wish to do so they would need to seek authorization under FSMA from the FSA.

2.24 In GB, apart from the few IPSs that are insurers, notably the Cooperative Insurance Society, there are very few other IPSs involved in the provision of regulated financial services. The Co-op Bank is registered as a company and is a wholly-owned subsidiary of the Co-op Group. Any IPS in the UK undertaking regulated financial services (in addition to deposit taking, which is exempt under FSMA up to £20,000) is subject to FSA regulation.

Qualifications for registration

2.25 An NI IPS qualifies for registration under the 1969 Act if it is formed for the purpose of carrying on any industry, business or trade and it satisfies the DETINI Registrar that it is a bona fide co-operative society or, if its business is for the benefit of the community, (a 'BenCom') it should be registered under the 1969 Act rather than as a company.

Bona Fide Co-operative Societies

2.26 There is no statutory definition of a bona fide co-operative society, although the following criteria have developed over the years and are generally accepted:

- members' benefits in the main stem from their participation in the business of the society;
- control of the society is vested in the members equally, through the principle of "one person, one vote";
- return on capital does not exceed a rate necessary to retain sufficient capital to carry out the society's objectives;
- any profits after payment of interest will, if distributable amongst the members, be distributed in proportion to the extent to which the members have traded with or taken part in the society's business; and
- membership will not be restricted artificially with the object of increasing the value of proprietary rights and interests.

2.27 The formation and continuation of a bona fide cooperative society pre-supposes a genuine community interest amongst its members based on something other than the amount of capital they may have placed in the society.

Societies for the Benefit of the Community

2.28 As well as operating its business in the interests of the community, a prospective BenCom should be non-profit making, its rules should prohibit distribution of assets among members and it needs to satisfy the same conditions relating to member control, interest rates, etc. as those applying to bona fide co-operatives. Housing associations are often registered as BenComs.

⁸ Note that the NI Directors' Disqualification regime has applied to NI IPSs since 2006 (see NI I&P 2006 Order)

⁹ See the Financial Services and Markets Act 2000 (Exemption)(Amendment)(No2) Order 2003 – SI 2003/1675.

Compensation

2.29 IPSs registered anywhere in the UK that provide financial services, such as insurance, are required to obtain approval from, and be regulated by, the FSA. As is the case for NI credit unions, deposits in IPSs across the UK, which are held in the form of withdrawable share capital, are not protected by the FSCS. Members' money is at risk in exactly the same way as if they invested in company shares.

Learning lessons from the PMS experience

2.30 The PMS went into administration in November 2008, following a 'run' on the society's funds. Then over 10,000 members were unable to gain access to their money, which is still tied up in the process of administration.

2.31 The FSA subsequently investigated the PMS, and concluded that the society was 'conducting regulated activities without the necessary authorisation or exemption'¹⁰. The FSA has decided not to prosecute those responsible for running the PMS at this stage.

2.32 It is beyond the scope of this review to investigate the circumstances surrounding the difficulties experienced by the PMS, or to make recommendations in relation to a particular institution. That is for the FSA, the NI authorities and the administrator.

2.33 However, it seems clear from the representations received by the Government, and from the individual PMS members quoted in the media, that members had no idea that their money was at risk. Their impression was that PMS was, in effect, a bank, an impression which may have been underlined by the fact that the society offered financial products for which it should have sought authorisation.

2.34 The main lesson to be learned is one of transparency, that an institution offering shares must tell its members the nature of their investment, and that their capital is at risk.

2.35 Cooperatives UK issues a voluntary code of practice on withdrawable share capital which, among other things, requires societies to inform members and prospective members in writing "at the earliest opportunity" as follows:

- "This society abides by a code of practice which requires it to provide a statement to its shareholders of the nature of their investment and any change affecting it. The position you occupy as a shareholder of "X" society is no different from that of a shareholder in any other corporate body in the sense that, if "X" society fails, you may not have all, or any, of your investment returned to you. Your investment is withdrawable without penalty at the discretion of the Board. The society, unlike banks and building societies, is not subject to prudential supervision by the Financial Services Authority." Cooperatives UK are currently revising the Code, in collaboration with the FSA.

¹⁰ www.fsa.gov.uk/pages/Library/Communications/Statements/2009/presbyterian.shtml

3

Stakeholder views

Report by the Committee for Enterprise, Trade and Investment

3.1 The Treasury review draws on the report by the Committee for Enterprise, Trade and Investment (ETI), which examined the role and potential of credit unions in NI¹. The terms of reference of the Committee's inquiry are set out in Annex B. The inquiry did not review the position of IPSs in NI.

3.2 The ETI Committee noted the disparity between what credit unions could do in GB and NI, and considered a number of options for reducing the gap in flexibilities between them. The Committee rejected the option of maintaining the status quo, and considered the following lead options:

Option 1 – Delegate FSA regulatory powers to DETINI

Option 2 – Share regulation between FSA and DETINI

Option 3 – Formation, by NI credit unions, of a registered company through which an expanded range of services could be provided

Option 4 - Retention of credit union registration within DETINI Companies Registry and transfer of credit union regulation to the FSA.

3.3 Options 1 and 2 were popular with NI stakeholders, but, in the end, the Committee recommended Option 4. It considered that this would provide all NI credit union members with access to a compensation scheme on common terms, whilst retaining a distinctive NI legislative framework. An extract from the ETI Committee report is included at Annex E.

3.4 This review did not consider Options 1-3, above. Delegation or dual regulation by the FSA and DETINI have been firmly rejected by the FSA (Annex D contains an extract from the FSA's evidence to the Committee). The FSA argued that there would be insufficient clarity about who regulates; that the FSA brand should be protected by requiring all institutions to meet a minimum standard; and that comparable institutions should be regulated in the same way. The Review saw no case for reopening that debate. The Treasury review has no locus in Option 3, which the NI Assembly and NI credit unions could take forward together. Moreover, Options 3 and 4 are not mutually exclusive.

Credit Unions

3.5 With few exceptions, NI credit unions and their representative trade associations, said that they want to expand their range of services, not only to cover the current range offered in GB, but also those that will be available following implementation of the 2007 GB review. Both UFCU and ILCU were clear that the current legal and regulatory framework is holding back the development of the sector and its ability to participate in government-backed schemes, such as the Child Trust Fund and the Saving Gateway.

¹ "Report on the Committee's Inquiry into the Role and Potential of Credit Unions in Northern Ireland". February 2008.

3.6 The trade bodies gave qualified support for a move to regulation by the FSA, although they expressed concern that a transfer should be sympathetically handled and that there would not be pressure placed on credit unions to take up new powers or activities if they did not wish to do so. They also said that, if credit unions did come under FSA regulation, the FSA should open a permanent office in NI.

3.7 Both the UFCU and the ILCU expressed concern about the potential costs of joining the FSCS and of regulation by the FSA generally. A particular concern of the sector in NI is that it should not be required to contribute towards the funding of any failures that happened prior to its joining the FSCS. They also suggested that the transitional arrangements for obtaining a Part IV permission under FSMA and meeting the "approved persons" requirements should permit grandfathering.

3.8 The NI credit unions also said they would like to have greater involvement in consumer information and education, and more opportunities for community investment.

Industrial and Provident Societies

3.9 Discussions with representatives of the IPS sector, covering housing, agriculture and community investment, identified similar issues to those expressed by respondents to the GB consultation on IPS legislation.

3.10 For example, the sector said that access to funding was a problem, particularly the limits on member investment in withdrawable share capital. It also said that improvements in the governance framework would be welcome, particularly those that improve the clarity of communications with members.

3.11 In addition, there was some enthusiasm for looking at how anti-money laundering² and prospectus rules³ might be applied proportionately to NI IPSs. The sector argued that it would be beneficial for IPSs and their members to have clearer information, particularly in relation to transactions between themselves, and that the possibility of mis-selling might be reduced. The sector emphasised, however, that applying the full weight of the two regimes could be counter-productive and potentially put IPSs out of business.

Financial Services Authority

3.12 The FSA felt that it has the capability to bring NI credit unions into the FSMA regime, as it already has the experience of integrating GB credit unions into its regulatory regime in 2002. It signalled that it would be happy to work with DETINI on managing the transition to FSA regulation and in carrying out "due diligence". However, as suggested in their evidence to the ETI Committee, it is unlikely that the FSA would move to having any permanent office in NI.

3.13 The FSA is already undertaking a review of the GB credit unions regulatory regime. The adoption of a further 181 credit unions, operating under a different legislative framework, would be a significant challenge. It estimates that the transition would take around 18 months from the point the necessary legislation was in place.

² Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

³ Commission Regulation (CE) 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements (as amended). If IPSs were to offer transferable shares then would need to bear in mind the application of s. 85(5) and Sch. 11 to FSMA as to whether the rules have application to IPSs.

4

Recommendations

Credit Unions

4.1 The review considered the following options:

Option 1 - do nothing

Option 2 - regulate credit unions under FSMA, leaving the legislative and registrar functions with NI (ETI Committee preferred option)

Option 3 - repeal NI legislation and integrate NI credit unions into the GB legal and regulatory framework.

Option 1 - Do nothing

4.2 The majority of NI credit unions have access to a compensation scheme for their members or a liquidity scheme, although not to the FSCS. The Assembly could, if it chose, make arrangements to recognise these schemes formally and set up a compensation scheme to cover those credit unions which are outside the current arrangements. There may be issues of unequal coverage, but these would be for the Assembly.

4.3 The Assembly could also update NI legislation in line with the changes being made for GB credit unions, although this would require primary legislation in the Assembly.

4.4 Additional changes discussed in the ETI Committee report that are not contained in the GB reforms, for example, community investment, could also be implemented by the Assembly.

4.5 Although many positive changes could be made, NI credit unions would not be able to carry on regulated activities in addition to deposit taking without losing the benefit of the FSMA deposit taking exemption. Widening the current exemption would face significant legal obstacles because it would be likely to fall foul of UK obligations to implement EU law, for example, on insurance intermediation. This means that there is a risk that any credit union that wanted to take on regulated activities outside the current exemption would become subject to dual regulation, with costs imposed both by the FSA and DETINI.

4.6 The 'do nothing' option would therefore continue to limit the activities of NI credit unions. It might also continue to be a barrier to the attainment of financial inclusion and financial capability objectives, which increasingly form part of the overall strategy for credit unions in GB.

Option 2 - Regulate NI credit unions under FSMA, leaving the legislative and registrar functions with Northern Ireland

4.7 This option is the same as the main recommendation of the ETI Committee.

4.8 The transfer of regulation to the FSA would enable members to have access to the FSCS and the FOS, with compensation of up to £50,000 in the event of the failure of a credit union.

4.9 Currently NI credit unions pay DETINI on a transaction basis rather than paying a single periodic levy. The table below gives examples of the fees that could be payable next year by three notional NI credit unions regulated by the FSA, using the FSA calculator and assuming that

the FSA fee proposals for 2009-10 go through unchanged. The examples are: medium (the average NI credit union in 2005), small (the average divided by 10) and large (the average multiplied by 10). The relevant variables available for 2005 were: members share capital, total assets, investments, and the number of credit unions. The illustrations below provide an order of magnitude, and should not be taken as precise estimates.

4.10 It is difficult to compare these costs with those currently charged by DETINI, as the fees will depend on what transactions credit unions carry out with the Department over the year. An amendment to rules, for example, would cost £170.¹

Table 4.A: Illustration of how FSA, FSCS and FOS fees might apply to a range of NI credit unions

	FSA		FSCS		FOS	
Tariff base	Modified Eligible Liabilities (MEL)		Protected Deposit (PD)		Gross Assets (GA)	
Definition	Deposits with the credit union LESS the credit union's bank deposits (investments + cash at bank)		Aggregate of shares and deposits		Gross assets (But CUs charged a flat fee)	
	MEL £	Fee £	PD £	Fee £	GA £	Fee £
	2005	2009/10	2005	2009/10	2005	2009/10
Average NICU	3,200,243	1,007	3,644,227	103	4,178,144	50
Small (average NICU/10)	320/024	151	364,422	12	417,814	50
Large (average NICU*10)	32,002,430	1,664	36,442,270	760	41,781,440	50

4.11 Under Option 2 the exemption order covering NI credit unions would need to be revoked, and every credit union would require a Part IV permission under FSMA to undertake deposit taking. Every member of the credit union board and senior executives would also be required to meet the Approved Persons requirements of FSMA.

4.12 The absorption by the FSA of 181 additional credit unions would present logistical challenges, although this could be done in a similar way as the 620 or so GB credit unions which were transferred to FSA regulation in 2002. NI credit unions would be subject to "grandfathering" providing it was appropriate and that the FSA could attach any conditions that may be needed to their permissions.

4.13 GB credit unions were grandfathered into the FSA regulatory framework. Where systems needed to be upgraded a two-year timeframe was agreed for the credit unions to meet the regulatory requirements. The majority of credit unions were absorbed into the FSA regime with full Part IV FSMA permissions, although some had variations or modifications to their permissions while they worked to meet the regulatory baseline.

4.14 At the same time, the Industrial and Provident Societies Acts and the Credit Unions Act were amended to make them compatible with FSMA. A similar process would need to be carried out with the equivalent NI legislation.

4.15 The FSA would need to review its rules for credit unions in the context of any differences between GB and NI credit union legislation and would also need to carry out "due diligence"² on

¹ Credit Unions (Fees) Regulations (Northern Ireland) 1994 (SI 1994/436)

² In this context "due diligence" refers to an investigation into the financial activities and management of the business in order to make an assessment of the key risks and to be satisfied that the board is fit and proper for the purpose of running a credit union.

the NI sector. This would involve working closely with DETINI and separating out the registration functions from those related to regulation.

Option 3 - Integrate NI credit unions into the GB legal and regulatory framework.

4.16 This option was not considered by the ETI Committee. It would have the effect of removing the unique NI framework and transferring all responsibility to Westminster. All credit unions would be subject to the same legal framework covering both registration and regulation and the powers available to credit unions would be identical without the need for separate updating of the NI legislation.

4.17 However, this option was not supported by the NI credit unions sector, and implementing it would require primary legislation at Westminster and a cross-community vote in the Assembly³.

Conclusions and recommendations – credit unions

4.18 Option 1 would maintain the existing position in terms of consumer protection. While the NI credit union sector is very stable, there are still some credit union members who do not have any kind of depositor protection. This option would also only allow the sector to expand into new areas of financial services at the likely cost of expensive dual regulation.

4.19 Option 2 offers an integrated regulatory structure, enabling access to government initiatives such as the Growth Fund and Child Trust Fund because credit unions would contribute to the Financial Services Compensation Scheme. It would be up to the Assembly to match the GB reforms, should it wish to do so, freeing NI credit unions to provide a wider range of services, or to legislate for NI-specific measures such as community investment. This option would also give clarity and equality of treatment across the UK on consumer protection.

4.20 Although Option 3 is the simplest in terms of outcome, and would meet the needs of the sector to expand, it does not command support with NI stakeholders.

4.21 It is for the NI authorities and credit unions to identify what route they want to take, but the best available if they want to come within a universal protection scheme is for NI credit unions to come under FSA regulation. This could not be done without the agreement of the Government, as the change to the FSMA exemption order would have to be made by the Treasury.

4.22 Option 2 is not without drawbacks: the transfer of regulation would not be straightforward and there would need to be amendments to the legislative framework both in NI and GB.

4.23 Despite the drawbacks, the review considers this option represents the best compromise. The FSA has indicated that it is willing to work closely with the NI authorities and credit union sector to develop a transition framework, which would minimise burdens as far as possible.

4.24 The Review recommends that the Government and NI Assembly should consult on bringing NI credit unions within the scope of the Financial Services and Markets Act 2000 (FSMA), while leaving the legislative and registration functions with the Northern Ireland Assembly and DETINI.

³ The subject matter of the Credit Unions (Northern Ireland) Order 1985 and the Industrial and Provident Societies Act (Northern Ireland) is within the legislative competence of the Northern Ireland Assembly, and by convention the UK Government will not legislate without the consent of the Northern Ireland Assembly.

Industrial and Provident Societies

4.25 The review considered the following options:

Option 1 – Do Nothing

Option 2 – Action for the NI Assembly and HM Treasury

Option 3 - Repeal NI legislation and integrate NI IPSs into the GB legal and regulatory framework.

Option 1 - Do nothing

4.26 The Industrial and Provident Societies Act (Northern Ireland) 1969 is similar to that governing GB IPSs under the Industrial and Provident Societies Act 1965. It has the same strengths and weaknesses and is significantly out of date in relation to company law, particularly the governance arrangements set out in the Companies Act 2006.

4.27 Outside of financial services, IPS legislation does not impose any constraints on the services that may be offered, rather it is just an alternative form of ownership.

4.28 Without reform, the framework for NI IPSs would begin to lag behind that for GB, as the measures arising from the 2007 review are implemented, and hence may discourage use of the mutual ownership model in NI.

4.29 The arguments for retaining the registration function in NI apply equally to IPSs as to credit unions. For NI IPSs regulation by the FSA is not an issue as they do not carry out activities falling within the ambit of FSMA, apart from the acceptance of deposits up to a maximum of £20,000, which is subject to an exemption order⁴.

Option 2 - Action for NI Assembly and HM Treasury

4.30 The NI Assembly could choose to amend and update the IPS legislation, along the lines being proposed for GB IPSs: this would require an Assembly Bill. Any such Bill could adopt measures, such as modifying the rules on share capital and providing for the assimilation of company law into IPS law, currently under consideration in GB. The NI authorities could also consider measures to improve transparency and governance arrangements in the sector.

4.31 The range and scope of IPSs and the way in which withdrawable share capital is used within the sector has been a cause of confusion, and at least in one case, inappropriate practices. It is therefore appropriate to consider how improved governance measures might benefit the sector without damaging its diversity and ability to operate effectively. Stakeholder feedback indicated a clear consensus in favour of proportionate application of the Prospectus and Money Laundering Directives to IPSs.

4.32 The Prospectus Directive⁵ requires a body offering shares to the public in the EU to issue a prospectus, which complies with the detailed rules issued by the home state. Many of the disclosure requirements contained in the Directive appear appropriate to the business of IPSs, although there is an exemption for non profit-making bodies. However, the requirements only apply to transferable shares, which are not commonly issued by IPSs and, even where they are, not usually to the public.

⁴ IPSs in GB and in NI are exempt from the general prohibition in section 19 FSMA insofar as they accept deposits in the form of withdrawable share capital (SI 2001/1201). In GB and NI, IPSs with withdrawable share capital may not carry on the business of banking, but taking deposits within the specified limits does not constitute banking (section 7 of the 1965 Act and section 7 of the 1969 Act).

⁵ Prospectus Directive 2003/71/EC

4.33 The “Financial Promotions” (Finprom) regime under the Financial Services and Markets Act 2000 and the FSMA 2000 (Financial Promotion) Order 2005 restricts financial promotions by persons who are not authorised persons. The regime applies UK-wide. A communication is a financial promotion on the basis of whether it is "an invitation or inducement to engage in investment activity"; regardless of the way it is communicated.

4.34 Currently there are various exemptions in the Financial Promotions Order for industrial and provident societies; the regime does not apply in full⁶. Applying Finprom in full to all IPSs, including those that only issue £1 shares to confer membership rights would be disproportionate.

4.35 The Financial Promotions Order is made by the Treasury, and the NI Assembly does not have the power to legislate on Finprom, without consent. However the issues raised in relation to IPSs in the course of the Review apply as much to GB as NI. In consultation with the Assembly (in relation to NI), the Treasury should review the position on the application of the Finprom regime to withdrawable share capital held in IPSs in both GB and NI.

4.36 Where funds are invested in the form of transferable shares then the continued application of Finprom is appropriate.

4.37 The Money Laundering Regulations 2007 implement the Money Laundering Directive in the UK. Compliance is overseen by the FSA in GB and by DETINI in relation to NI credit unions and guidance is issued on their application. The Regulations are not applied to IPSs in either GB or NI when they issue withdrawable share capital within the current limit of £20,000 per share, or de minimis deposits or transferable share capital only.

4.38 In the UK the Money Laundering Regulations apply to all credit unions. Taking account of the fact that many UK credit unions are small in size and that not all members may have the same proofs of identity as might apply to bank customers, the requirements are modified to meet the needs of the sector⁷.

4.39 The review has not identified that IPSs as whole have a problem in relation to money-laundering, but where societies take deposits that are exempt from regulation, it is arguable that they may be open to abuse or mismanagement because of the lack of transparency. In considering the appropriate response the scale and scope of IPS businesses and the level of deposit taking that is undertaken must be considered.

4.40 Where deposits are made in the form of shares, excluding nominal membership shares and minimal amounts, the application of the Money Laundering Regulations would be a safeguard to members and their societies. This would involve removing the current exemption in respect of withdrawable share capital contained in the Money Laundering Regulations, which could be achieved in an order made by the Treasury. Clearly this would not be directly a deposit protection measure but would help reduce the risk to societies and their members generally and in terms of money laundering, in particular.

Option 3 - Integrate NI IPSs into the GB legal and regulatory framework.

4.41 This option is the equivalent to Option 3 for credit unions, and the same arguments for and against it apply.

⁶ Article 35 and Schedule 1 Paras. 14 and 15 to FSMA 2000 (Financial Promotions) Order. (SI 2005/1529)

⁷ The FSA has issued guidance to GB credit unions on appropriate forms of identity.

Conclusions and recommendations - Industrial and Provident Societies

4.42 IPS legislation in NI is very similar to that in GB, and there are no compelling arguments for integration into a UK-wide framework. Equally, the case for updating GB legislation applies also to NI, particularly in relation to improving corporate governance and disclosure. Option 1 maintains the current position, with its inbuilt weaknesses in terms of corporate governance and transparency. In addition doing nothing would mean that the legislative framework falls further behind that in GB, as the current reform programme is implemented. As is the case for credit unions, Option 3 is not an outcome that finds any favour with stakeholders in NI.

4.43 The Review therefore recommends that the NI authorities consider what could be done to improve the NI legislation, with the aim of improving transparency and governance following the proposals in Option 2. Second, that the Treasury, on a UK wide basis in consultation with the NI Executive should identify the appropriate regime to ensure that members of IPSs receive accurate and timely information when they are placing their money with an IPS. This might be through self-regulation through the application of a Code, or through amending the Financial Promotions Order, or a combination of both. Similarly in GB, the FSA and the sector should identify an appropriate approach to minimise the risk of money laundering and improve transparency between IPSs and their members to maintain confidence in the sector. The NI Authorities, the Treasury and the FSA working together to develop a unified regime that protects societies and their members should achieve an integrated approach across the UK.

A

Terms of reference

- 1 To identify the impact of the legislative and regulatory framework on credit unions and industrial and provident societies in Northern Ireland, in particular, to compare the position of Northern Ireland and Great Britain members in respect of:

The effectiveness of arrangements for depositor protection

The services that may be offered.

Consumer information and education.

- 2 To consult stakeholders on recommendations for any changes to the regulatory framework to strengthen member safeguards and structure of credit unions and industrial and provident societies in Northern Ireland.

The review will build on the inquiry into credit unions undertaken by the Northern Ireland Assembly Enterprise, Trade and Industry Committee. It will also consider best practice in other countries.

B ETI committee terms of reference

Assess the current ethos, regulation and legislation of credit unions in Northern Ireland and compare these with provisions in Great Britain and Republic of Ireland.

Compare the different services available to credit union members in Northern Ireland, Great Britain and the Republic of Ireland.

Assess the role and contribution of credit unions in promoting the financial well being of their members and wider community.

Examine the legal and regulatory barriers preventing credit unions from participating in the 'business of banking' and promoting financial inclusion.

Compare the role and availability of public funding available to credit unions in Great Britain, Northern Ireland and the Republic of Ireland.

Examine what policy development and practices have taken place since the Review of Credit Unions.

Assess the Treasury Select Committee recommendations on credit unions.



Review consultees

Committee for Enterprise, Trade and Investment

Department of Enterprise, Trade and Investment – Companies Registry

Financial Services Authority

Irish League of Credit Unions

Ulster Federation of Credit Unions

Co-ops UK

Northern Ireland Federation of Housing Associations

Co-ownership Housing

Ulster Community Investment Trust

United Dairy Farmers

Fane Valley Co-op

D

Extract of evidence from the FSA to the Enterprise Committee

"...We are aware of the discussions on whether Northern Ireland credit unions should be brought within the scope of FSA regulation. We are also aware that there are questions about whether a form of dual regulation — or sharing of regulatory responsibilities — could be put in place in respect of Northern Ireland credit unions. Our position is simple: we are not seeking to change the present arrangements whereby we have responsibility for credit unions in Great Britain and the Northern Ireland authorities have responsibility for credit unions here. In saying that, if such a change were to happen, we would not oppose it. However, we are clear that it would need to be a case of bringing Northern Ireland credit unions within the scope of FSA regulation. We are not in favour of sharing, or dividing, the regulation of Northern Ireland credit unions between ourselves and the relevant Department here.

.... There are several reasons for our position: first, the simplicity and clarity of the message to consumers would be open to question. Consumers would need to know who the regulator would be and what standards their credit unions would be required to meet. Our experience is that it is of the utmost importance to have a clear, straightforward message.

Secondly, we are jealous of the FSA brand. Institutions that come within the scope of our regulation must reach a certain standard, and when determining whether institutions meet that standard we apply a methodology, which is continually evolving and improving. Therefore, it is very important that any institution carrying the FSA brand is regulated in the same way as other comparable institutions on our register. I am not saying that we regulate small credit unions in the same way as large banks; rather that small credit unions here would be regulated in broadly the same way as those in GB.

Thirdly, the FSA believes that some methods for sharing responsibility could create significant problems within the Northern Ireland market. For example, were we to regulate the large credit unions here while the small credit unions remained within Northern Ireland regulation, or were we to take responsibility for some credit union activities while others were taken on by the relevant Department here, that would send out a confusing message and could lead to competitive inequality within the Northern Ireland market.

For those broad reasons, and several other technical reasons on which I could expand, we are not keen on — in fact, we would be opposed to — the middle way that would involve sharing or delegating responsibility."

E

Extract from: Options for Change

Option 4 – Retention of all credit union registration within DETI Companies Registry and transfer of all credit union regulation to the FSA

85. Under this option, all responsibility for the regulation of credit unions would transfer from DETI Companies Registry to the FSA. All Northern Ireland credit unions would come under the FSMA.

86. As with Option 1, DETI's understanding of this option is that it would require amendment to both the Credits Unions (Northern Ireland) Order 1985 and the FSMA. Again, time in both the Assembly and Westminster would be required to put this option into operation⁸⁸. DETI goes on to state that, if the

Executive and HM Treasury were to agree to this option and the FSA were to exercise policy and regulatory responsibility for credit unions registered in Northern Ireland:

"future legislative changes would apply automatically and simultaneously in Northern Ireland and in GB. NI credit Unions would need to meet FSA requirements to be authorised to operate, which would also bring with it the protection of the Financial Services Compensation Scheme."

87. Although it is not their preferred option, the UFCU state that, as long as the FSA looks after credit unions as well as DETI Companies Registry have done it should not be a problem. They state that it would be successful:

"as long as the customer – the wee man at the end of the street – has a credit union system that he can be proud of⁸⁹."

88. The ILCU feel that the FSA is not justified in its reluctance to delegate responsibility for regulation under the FSMA to DETI Companies Registry⁹⁰. The ILCU does not believe it is necessary for Northern Ireland credit unions to be regulated by the FSA in order to be able to offer a full range of services, stating that:

"The FSA's true position is that it will not oppose change as long as it takes the form of a complete shift of all credit unions in the Province from DETI to the FSA. That is entirely contrary to the intention of the Northern Ireland Act 1998, which was – and remains – that credit unions are a devolved matter to be dealt with by this Assembly⁹¹"

89. The ILCU does, however recognise that whatever outcome is agreed, the result must be that credit unions in Northern Ireland must be in a position to offer a wider range of services. They state that:

"There must be a positive recommendation that will allow credit unions in Northern Ireland to extend the range of services they can offer⁹²."

90. If Option 4 is the only option, the ILCU state that they do not have a mandate from their membership to accept this option. They state:

"It will be up to us to persuade our members, if it comes to the point that that is the only option⁹³."

91. ABCUL represents the interests of the majority of credit unions in GB. Their members are currently regulated by the FSA. They believe that FSA regulation works well and is not difficult to operate⁹⁴. They state that FSA regulation is:

"one of the best things that has happened to credit unions in Britain⁹⁵."

92. In relation to the challenges which FSA regulation brought with it, ABCUL states that the FSA has an individual relationship with each credit union. It recognises that there was a real challenge concerning the degree of face-to-face supervision and regulatory visits versus desktop supervision but goes on to state that:

“A good balance has now been reached, and quite innovative things have been done to get round some of those challenges. By and large, that relationship has been a good experience⁹⁶.”

93. The BBA supports this view, stating that:

“The FSA’s regulatory model — or CRED, the credit unions’ sourcebook — is not as onerous as some might think⁹⁷.”

94. In relation to Option 4, the BBA have expressed strong views in support. In their written submission to the Committee they state that:

“Offering more complex banking services does require a robust infrastructure to support business activity. To achieve the desired level of consistency, it is suggested that all UK financial services providers should be regulated by the same body, and accordingly that credit unions in NI should be subject to the prudential supervision and consumer protection requirements of the FSA (in common with their GB counterparts, and as is already the case for banks in NI). A common supervisor would also allow credit unions to apply to extend their services and products on an individual basis, without the imposition of a one-size-fits-all solution which, in some cases, may be inappropriate⁹⁸.”

95. The FSA states that it is not seeking to take over regulation of credit unions in Northern Ireland but would not turn down the opportunity if it arose⁹⁹. That stated, it is clear that the only other option which the FSA would support is Option 3, which does not receive support from other key stakeholders.

96. It is unclear why the ILCU is so opposed to this option to the extent that it is. The Committee recognises that this option is not preferred by the credit union movement here, which would have to come to terms with changes in the way credit unions are regulated and with changes to the personalities involved in regulation. Given the level of support expressed by ABCUL for FSA regulation, the Committee believes that, subject to a well supported settling in period, this option would succeed. The Committee does however, have some concerns in relation to this option. The Committee’s main concern is, that, given the number and size of credit unions in Northern Ireland, coupled with the close working relationship the movement has developed and maintains with DETI Companies Registry, the fact that FSA does not have a presence in Northern Ireland would pose real difficulties for credit unions here. The FSA has its headquarters in London and has a small office in Edinburgh. It states that it has no plans to, and will give no commitment to changing that arrangement¹⁰⁰. Credit unions would have to come to terms with a completely new regulatory regime and, in addition, many would have to come to terms with the development and delivery of a whole new range of services. The complete withdrawal of current levels of support at a time of increased need would create major difficulties for credit unions. The Committee believes that, for this option to succeed, it would be necessary for credit unions to very quickly foster close working relationships with the FSA.

F

Credit union legislation and regulation internationally

Credit unions have been important contributors to economic and social development since their inception in Europe in the 1830s. They are increasingly significant participants in the national financial markets of many industrialized, developing and transitional economies. Nonetheless, legislation has not always kept pace with the development of the sector. Inadequate legislation and or regulatory deficiencies threaten the safety and soundness of credit unions and restrict their ability to meet their members' financial service needs.

The worldwide growth of credit unions and their increasing integration into the provision of financial services, particularly to the lower and middle income groups, has stimulated legislative and regulatory reform in a number of countries, both developed and developing.

Some of the issues that are under consideration in other jurisdictions are set out below and provided a reference point for the development of legislation in the UK. A common theme in other jurisdictions is the integration of credit unions into mainstream financial services regulation. At the same time there is an increasing impetus to allow credit unions greater freedom to offer services to their members and their communities more generally.

In Australia funding and the credit issues have become a central focus for regulators as the credit crisis continues to have an impact on credit unions there. Regulators are particularly interested in credit union strategies for obtaining wholesale funding in an environment where credit is tight and expensive. Regulators are also looking at credit union efforts to develop retail deposits.

Canada has implemented amendments to bring Canadian legislation in line with the recommendations of the Financial Action Task Force. Credit unions have recognised that a robust anti-money-laundering and anti-terrorist financing legislation unnecessary to safeguard their members and the economy more generally. The approach has been based on finding a risk-based approach to anti-money-laundering compliance that is appropriate to the sector.

In the Caribbean modernising existing legislation and enhancing regulatory structures has become a priority. This follows the work of Barbados and the Bahamas producing new legislation the regulation of credit unions. The impetus for change has been affected by the food and energy prices affecting the region and the importance of credit unions in strengthening the capacities of producer and supplier cooperatives.

In Poland work has been done to update cooperative legislation that has been in force for 25 years. The changes are aimed at securing the stability of the Polish credit unions sector by reinforcing supervision of credit unions, whilst at the same time increasing the number of services that can be provided by credit unions.

In the United States reforms have been under consideration to integrate credit union regulation with that for other financial institutions under one prudential regulator.

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This document can be found in full on our website at:
hm-treasury.gov.uk

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