Department of Enterprise, Trade and Investment
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REQUEST TO DETI FROM THE ETI COMMITTEE

At its meeting on 20 October the Committee considered correspondence from the UFCU in relation to the CUCCBS Bill.

Members asked the Department to comment on the issues raised by the UFCU.

DEPARTMENTAL RESPONSE

Issues raised by UFCU

Clause 1: Corporate Members of Credit Unions

Since credit unions were first established in Northern Ireland in the 1960s, they have grown significantly and have come to play a key role in offering financial services to their local communities.

To support the work of credit unions, DETI has taken forward a considerable programme of reform in recent years.

The transfer of the regulatory role to what is now the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) in March 2012 has allowed credit unions to expand the range and type of services they can offer while at the same time increasing protection for members' savings. At that time, DETI provided financial support to the Irish League of Credit Unions and the Ulster Federation of Credit Unions, so that they could help individual credit unions adjust to this new regulatory environment.

The Credit Unions and Cooperative and Community Benefit Societies Bill (the Bill) seeks to build upon this, giving Northern Ireland credit unions greater operational freedom, without moving them away from their mutual, socially beneficial and community-based roots.

Clause 1 as drafted, will allow credit unions for the first time to extend membership beyond individuals. Corporate bodies and organisations such as local businesses, community groups and sports clubs will be allowed to invest with their local credit union. It allows credit unions to grow their business, increase assets and support their local economy.

A 'corporate member' is:

- a body corporate;
- a partner acting for a partnership; and
- an officer or member of the governing body acting for an unincorporated association.

The Department believes that this will send a strong message to consumers in Northern Ireland that credit unions can not only offer services rivalling other financial institutions but are a cornerstone of the local economy.

In addition, the Department listened to the concerns of the trade bodies regarding the administrative burden caused by the closure of one account followed by the opening of

another, and changed the process in response (now permitting the transfer of rights and liabilities from one individual representative to another).

Naturally, the Bill contains safeguards and restrictions applying to corporate members which should ensure that the unique credit union ethos is unaffected and reassures customers that the sector continues to act in a prudent manner. The main safeguard is in relation to unincorporated associations as they have no legal personality.

The UFCU has listed some specific concerns:

1. **A Limited Company is a legal entity in its own right and therefore accounts must be opened in the name of the Limited Company.**

Clause 1 as drafted currently permits this.

2. **It would appear that the guidance as to how corporate membership should be handled originated from HM Treasury.**

The policy decision on how to treat unincorporated association accounts in credit unions was made by DETI and agreed by the NI Executive. This decision was informed by comments received from stakeholders including not only HMT but also the sector locally, UK sectoral bodies, the Prudential Regulation Authority, Financial Conduct Authority and the Department's own legislative advice.

The extent and scope of HMT advice received by DETI was confirmed in correspondence from HMT to the ETI Committee dated 17 September 2015:

> *"HM Treasury's interactions with Department of Enterprise, Trade and Investment on the Credit Unions and Co-operative and Community Benefit Societies Bill have simply been to share our rationale for the policy behind the drafting of the Legislative Reform Order 2011 ('the LRO') which applies to GB credit unions"*

3. **Unincorporated Accounts from bodies trading within the SME Sector, from clubs and societies can be opened in the name of the business or club or society in any of the banks within Northern Ireland. These accounts are opened in the name of the business or organisation and are operated by authorised signatories. There is absolutely no reason why similar arrangements should not prevail for Credit Unions operating in Northern Ireland.**

Although banks and credit unions often offer similar services, they are still very different financial institutions. Credit unions are not for profit; existing for the benefit of members, they allow communities to save together and to lend together at a fair and reasonable rate. Banks are many times larger with assets greatly in excess of those of credit unions. They operate for the profit of shareholders and can adopt higher levels of risk and costs.

An unincorporated association (UA) does not exist in the eyes of law, and therefore cannot enter into contracts, borrow money, hold property etc. This creates a prudential risk for credit unions and as advised to the ETI Committee on 30 January 2015, this could lead to a situation where a credit union is unable to recover monies owed, or increase the legal costs of recovery.

Paragraph 9 of Schedule 1 to the Bill provides that a credit union may make a loan to a corporate member only if the credit union's rules provide and subject to a 10% limit on loans made to corporate members. The 10% limit is based on the total amount of the outstanding balances on all loans made by the credit unions to members. On the basis of this 10% limit and the current total NI credit union lending of £509m, the possible exposure of NI credit unions to such authorised lending could be approximately £57m.

In the period since this legislation has been developed by DETI (2012-2015) six credit unions have failed (five UFCU, one independent) and several more have amalgamated. Hence, it is important that the Department heeds the possibility of prudential risks to credit unions and their members.

In regards as to how banks manage UA accounts, HM Treasury (HMT) consideration on the matter was provided to the ETI Committee on 31 July 2015:

> *"...in the UK Credit Unions can loan to unincorporated associations but the account will be in the name of an individual who will represent the association. Some banks do open accounts in the name of unincorporated associations but these appear to be accounts with very limited functionality (i.e. for deposits only which require a balance of over £10,000 before interest is payable).*
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> *We had to keep in mind that the risk profile for a bank is a lot different to that of a Credit Union. A bank is responsible to its shareholders for profits and this will influence the level of risk it is prepared to take on. Also, banks have much more detailed resources and procedures available to evaluate the risk profile of a particular client. This is not the case with a Credit Union and in the event of a default on a loan from an unincorporated association they will have to look to the members of the association to recoup any losses."*

Allowing UA accounts is a step change in itself and DETI, following discussions with HMT, the PRA and the FSCS, believes that to create further risk at this stage would be imprudent but is open to review this position. This draft Bill does not preclude the situation changing in the future.

In this vein, DETI committed to the UFCU and the Irish League of Credit Unions (ICLU) at a meeting in March 2015 to review the operation of UA. The ETI Committee suggested going further and an amendment to the Bill providing for a review of the clause concerning UA membership has now been included in the Bill:

> ***'Review of section 1***
> ***13A.****—(1) The Department must—*
> *(a) carry out a review of the operation of section 1 as it relates to unincorporated associations, and*
> *(b) prepare a report of that review.*
> *(2) The Department must lay the report before the Assembly.*
> *(3) The Department must begin to carry out the review before the end of the period of 2 years beginning with the day of Royal Assent.'*

In addition, discussions continue with the FCA to determine if some public facing documentation can have the UA name on it.

4. Death/divorce/tax liability of a person who is a member of a credit union on behalf of an unincorporated association

Provisions are contained in the Bill to determine what interest an individual who is representing an UA, has in the shares held by him on behalf of that UA in a credit union. For the purposes of this determination the shares will not be treated as being held by the individual. Clause 1(3) of the Bill provides:

> *"Where shares are allotted to an individual who is a corporate member, then for the purpose of determining the amount of the interest in the shares of the credit union held by each of its members—*
>
> *(a) the partnership or, as the case may be, the unincorporated association is to be treated as a member holding the shares, and*
>
> *(b) the shares are not to be treated as being held by the individual."*

There is also a safeguard in the Bill which specifically concerns the death of a credit union member. At present, a member of a credit union can nominate a person to receive their shares in the event of death. The Bill will allow a nomination to be made by an individual representing a UA (the nominator), but the property can pass only to another officer or member of the governing body of the UA (the nominee).

In circumstances where the individual representing the UA dies and has not completed a nomination then the new provisions of the Bill introduced for the transfer of shares can operate. In this case the shares held on behalf of the UA will transfer to the newly appointed representative.

5. It is our [UFCU's] understanding that in the event of the failure of a Credit Union the Financial Service Compensation Scheme will aim to return ALL monies to registered members within seven days. [An individual representing a unincorporated association] will receive a cheque for the amount in the account of the sports club, society or business registered with the credit union in his name. This presents the very real potential for fraud.

The Department would reiterate its advice to the ETI Committee of 8 April 2015:

> *"In its correspondence, the UFCU raised a concern about a particular practice of the UK Financial Services Compensation Scheme (FSCS), the body that can pay compensation to eligible depositors in banks, building societies and credit unions when they fail. In these circumstances, the FSCS sends out a cheque in the name of the individual representing an unincorporated association, rather than in the name of the association itself. The UFCU suggests to the Committee that this would present the opportunity for fraud.*
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> *This issue, being an operational matter, has been raised with the FSCS, which advises that it sees no reason why fraud would be more likely at failure than it would be whilst the unincorporated association funds were held in the credit union account to which the individual had access. In addition, should the credit union account for an unincorporated association have two or more signatories,*

compensation would be split equally and cheques issued to each individual. This would reduce significantly any scope for potential fraud.

The FSCS has confirmed that it has no plans to alter its existing practice of sending out compensation cheques in the name of a natural person rather than in the name of unincorporated associations which, the FSCS has emphasised, have no legal status."

6. Clause 10 Removal of Limit on Holding of Non-Withdrawable Shares

Clause 10 applies to Industrial and Provident Societies and not credit unions.

ANNEX 2

REQUEST TO DETI FROM THE ETI COMMITTEE

At its meeting on 3 November the Committee took oral evidence from officials in relation to the Credit Unions and Cooperative and community Benefit Societies Bill.

The Committee asked the Department to confirm that the Minister, when speaking about the Bill in Plenary Session, would commit to a review of the Bill.

DEPARTMENTAL RESPONSE

As the Committee were advised on 9 November 2015, the Department has brought forward an amendment to the Credit Unions and Cooperative and Community Benefit Societies Bill, which will place a statutory obligation on DETI to review, and report to the Assembly on, the operation of section 1 of the Bill as it relates to unincorporated associations.

DETI will also continue to review more generally the legislative framework underpinning credit unions and industrial and provident societies after conclusion of work on the Bill, and whether further legislative change is appropriate. The Minister is content to advise the Assembly of this when speaking about the Bill in plenary.