Credit Unions: A Vehicle for SME Funding in a Rebooting Post Covid-19 Economy

IRELAND

Irish League of Credit Unions

1. Executive Summary

1.1. Introduction

1.1.1. Credit unions have a significant footprint in the Republic of Ireland, with a total membership of **3.1 million** people. At 30 September 2019, there was a total of 241 credit unions registered in Ireland, with a combined asset base of €18.3 billion. Credit unions are dispersed in all 26 counties of the Republic of Ireland. The Irish credit union movement is part of a global movement of credit unions. There are over 85,000 credit unions on 6 continents, active in 108 countries around the world, serving a total membership of 274 million people. The global credit union movement is guided by common operating principles. These operating principles are founded in the philosophy of co-operation and its central values of equality, equity and mutual self-help.

1.1.2. The financial services landscape has transformed over the past decade; primarily economically and technologically. Like other market participants, Irish credit unions are generally under-lent, and, operating within a prolonged period of low interest rates resulting from the current accommodative monetary policy. In addition, the core demographic and psychographic profile of younger members is changing, with a growing set of needs that are more value oriented and digitally positioned. The credit union system in Ireland is addressing the current environmental challenges by diversifying into new income streams and by creating a digitally enabled compelling value proposition which is economically sustainable in longer term horizons.

1.1.3. The Irish League of Credit Unions (ILCU) is the largest credit union representative body on the island of Ireland. Founded in 1960 to provide representation, leadership, co-operation, support and development for credit unions in both Northern Ireland and the Republic of Ireland, the ILCU today has an affiliated membership of 326 credit unions – 234 in the Republic and 92 in the North. Membership of the ILCU is open to every credit union in Ireland. In January 2020, the Irish League of Credit Unions issued "Credit Unions 2020 Vision", a paper summarising policy priorities geared to align developmental policy for credit unions with effective regulatory oversight. The 2020 Vision emphasises that credit unions are not simply an alternative to banks. The credit union movement is a model of community banking with deep roots and widespread affinity that is the basis not just for what credit unions do now, but for delivering a much wider range of services as well.

1.2. Community Banking

1.2.1. The Programme for a Partnership Government contained a commitment to investigate the Sparkassen model of local public banks that operate within well-defined regions. This commitment was fulfilled by the Department of Finance and the Department of Rural and Community Development with the publication of the joint report on 'Local Public Banking in Ireland'[1]. In addition, the Government agreed that the Department of Finance would commission an independent external evaluation of how the local community banking concept may be furthered in other ways. Following this, in 2019, the Department of Finance engaged Indecon International Economic Consultants ("Indecon"), to undertake an independent evaluation of how the concept and objectives of community banking, and local provision of banking and financial services, may be furthered in Ireland. Indecon concluded that a distinctive feature of the Irish local financial services market is the role played by the credit union movement. Indecon noted that credit unions are critical elements of community banking and recommended that the Department of Finance should support the credit union movement to deliver an expanded range of community banking services.

1.3. Small and Medium Enterprise ("SME")

1.3.1. SMEs have played a vital role in the Irish economy. SMEs create employment, generate taxes, stimulate economic activity, and participate in the orderly supply of goods and services for the betterment of the wider population, both domestically and internationally.

1.3.2. In 2019, the OECD[2] (acting through the "OECD Studies on SMEs and Entrepreneurship") issued a report entitled "SME and Entrepreneurship Policy in Ireland". This publication presented an OECD country review of SMEs and entrepreneurship policy in Ireland. It was prepared at the request of the Department for Business, Enterprise and

[1] **Local Public Banking in Ireland** - An analysis of a model for developing a system of local public banking in Ireland, 2018. See Department of Finance Website

[2] The Organisation for Economic Co-operation and Development

Innovation ("DBEI") in the Irish Government and is part of the series of OECD Country Reviews on SME and Entrepreneurship Policy undertaken by the OECD Centre for Entrepreneurship, SMEs, Regions and Cities. The OECD noted that SMEs are a "critical pillar of the Irish economy". The OECD reported that there were approximately 250,000 active enterprises in Ireland, virtually all of them SMEs. The OECD noted that Ireland is very successful in generating high-growth firms, which are a key driver of employment, innovation, and productivity growth in the economy. SMEs in Ireland participate in mixed modes of innovation. Furthermore, Irish SMEs display the third-highest share of new-to-market production innovation in OECD economies. The SME share of business R&D in Ireland stood at almost 40% in 2015, above the OECD average of 35% (OECD, 2017).

1.3.3. The primary finance providers to SMEs in Ireland are the main retail banks[3], non-bank finance providers, the credit union movement, and State bodies and policy initiatives put in place to support and facilitate SME access to finance (following the Financial Crisis that commenced in 2008, a number of state policy supports were put in place to address the perceived market failure in the Irish banking and financial services market). In this regard, the SME lending market is dynamic, and, subject to many policy interventions by the State.

1.4. The devastating impact of COVID-19 on SMEs

1.4.1. The impact of the COVID-19 pandemic on the global economy has been severe. The pandemic outbreak and the measures required to contain its spread, have brought global markets to a near standstill, triggering a very sudden and sharp contraction in economic activity globally, nationally and locally. The entire spectrum of economic activity in Ireland has been impacted in varying measures. SMEs in Ireland are part of this economic narrative. The speed, suddenness and severity of the global economic shutdown has left, what were thriving small and medium sized businesses throughout Ireland pre COVID-19, utterly paralysed. The Nobel Prize-winning economist and New York Times columnist, Paul Krugman, likened the economic shutdown to a coma; "…this isn't a conventional recession; it's more like a medically induced coma, where you temporarily shut down much of the brain's activity to give it a chance to heal"[4]. In this regard, positioning SMEs in Ireland to once again, thrive, in a post COVID-19 Emergency, when awoken from the coma, is a matter of public interest.

1.4.2. The National Response Plan to the COVID-19[5] Emergency is built on principles of solidarity, reciprocity and care. The National Response Plan to the COVID-19 Emergency calls on Irish citizens to act collectively. The National Response Plan calls on everyone to play his or her part in combatting COVID-19. The National Response Plan to the COVID-19 Emergency states that solidarity, cohesion and determination on the part of everyone will assist in limiting the spread of this virus and protect the nation. The National Response Plan states that voluntary and community organisations are at the heart of the State's co-ordinated response to COVID-19, in caring for each other.

1.4.3. The Irish credit union movement is a voluntary community organisation. The Irish credit union movement has €18bn in assets and €3bn in reserves. The Irish credit union movement has multiple outlets in each and every county, with a touchpoint on 3.1m Irish citizens. The Irish credit union movement has backed both the Irish economy and Irish society from the 1950s. Credit unions are value-based organisations. Credit unions have a role to play in the National Response to COVID-19. This is the context in which our response to COVID-19 is set. When the Irish economy wakes from the "Krugman Coma", credit unions will be ready, willing and able to play a role, and serve the common good.

1.5. Our proposal

1.5.1. Following this, our proposition is broadly as follows; Irish credit unions would participate in a State-backed vehicle that would:

- Enable Irish credit unions to act as an efficient distribution network to originate SME loan applications, in a post COVID-19 "re-booting" environment.
- Enable Irish credit unions to invest in a funding facility that will lend to SMEs in Ireland.

1.5.2. We recognise that credit unions can, through the 2019 Regulations, inject 5% of their assets into SME lending, which currently would equate to €910m (with the regulations, in their generality, enabling an extension of limits in certain circumstances). Our

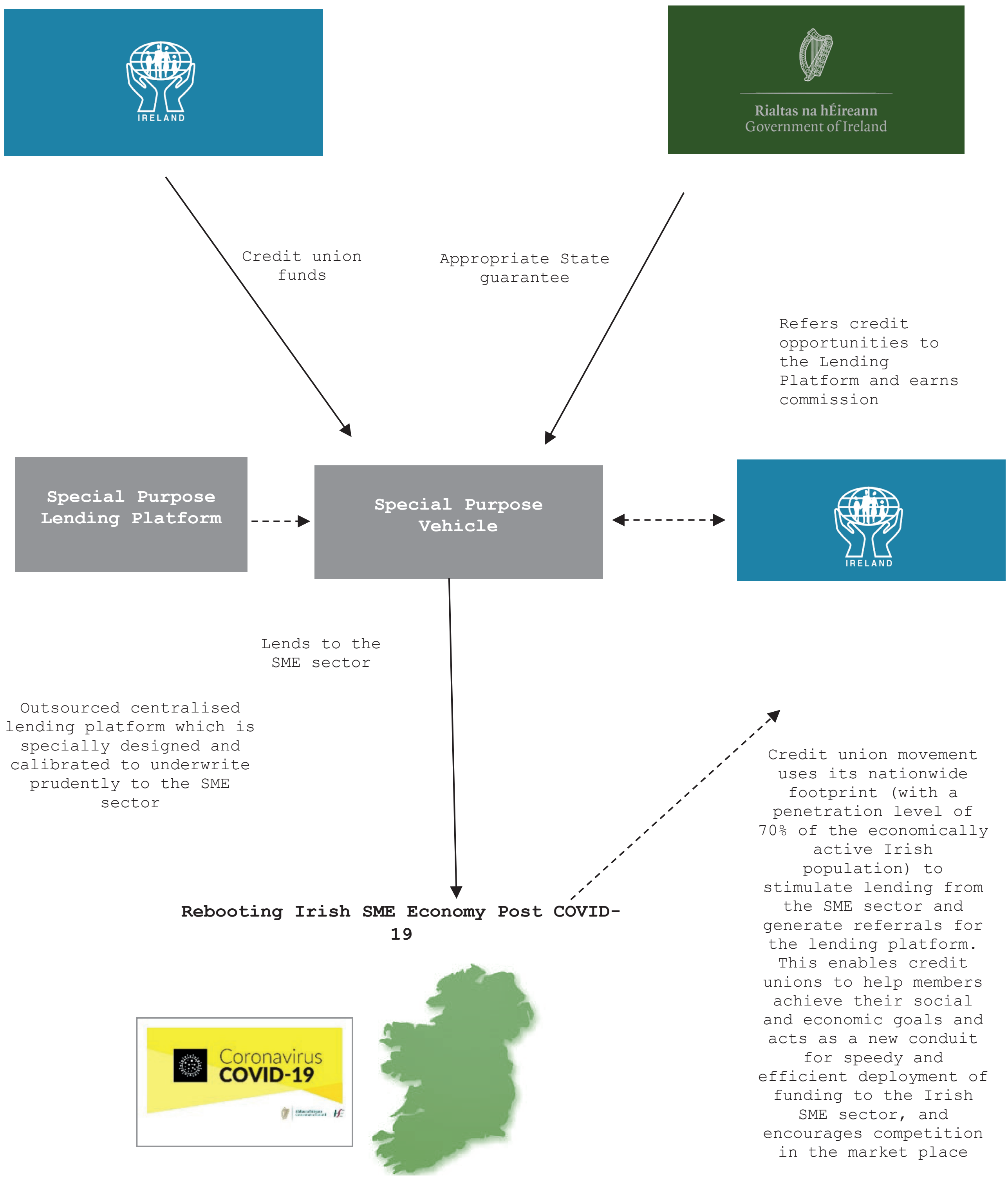
[3] Bank of Ireland, AIB, Permanent TSB, Ulster Bank and KBC

[4] @paulkrugman, Twitter ©

[5] Department of the Taoiseach, 16 March 2020

proposition is to go beyond this, and use a greater level of our €18.3bn in assets to stimulate a rebooted Irish economy.

1.5.3. An infographic setting out an outline of the proposal is shown below:

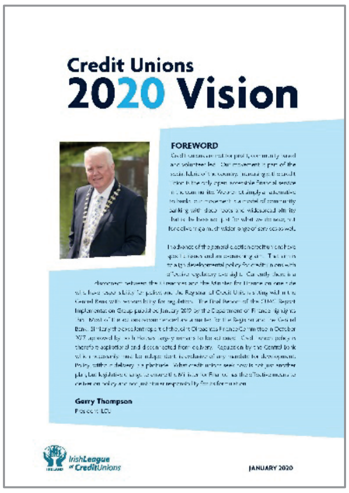


1.5.4. The **benefits for the State** of this proposal are set out below:

- Credit unions have an unparalleled reach within Irish communities. In a post COVID-19 world, the economy will need to be rebooted at speed, with all necessary supports. SMEs will require credit to rebuild their businesses. A structured credit union investment vehicle would enable the rapid infusion of credit into SMEs in all major population centres in the country. Credit unions are located throughout the country and interface with a significant portion of the economically active population of Ireland. Credit unions are different in structure, nature and ethos to retail banks. The credit union model could act as a new conduit for the State to stimulate borrowing in the SME market and support it with competitive loans in a speedy and effective manner, using the credit unions' pre-existing and mature infrastructure. The credit union movement has a wide socio-economic and political reach. Thousands of civic minded volunteers committed to furthering the social and economic goals of 3.1m people within the Irish State, are active in local communities and could provide a key link to the SME sector in communicating the availability of funding at grass-roots level.
- The vehicle would open up a far greater portion of the credit union movement's €18bn in assets. Current regulations limit business lending to 5% of assets (with the regulations, in their generality, enabling an extension of limits in certain circumstances). A state-backed investment vehicle would open up a far greater level of funds for Irish SMEs, in a prudent and sensible manner. The movement has substantial funds that are not lent, and these funds are currently economically and socially redundant.
- The proposal would also enhance competition in the market place.

1.5.5. The **benefits** of this proposal **for the credit union movement** are set out below:

- The key benefit arising for the credit union movement from the proposal would be that it would enable the movement to put a greater portion of its asset base, **€18bn**, to a more productive and economically rewarding purpose, at a time of national crisis. The proposal is built on principles of solidarity, reciprocity and care, and it enables the credit union movement to answer the Government call to act collectively, and enable the Government to deliver a cross-Government and public health-led response.
- Credit unions, by definition, exist to assist their members to attain their economic and social goals. On a wider economic level, the Irish credit union movement is, similar to other elements of the financial services landscape, highly sensitive to external economic factors. Given the economic importance of SMEs to the overall well-being of the wider economy, the Irish credit union movement has a strategic interest in supporting the SME sector as this should lead to a strengthening of the economic environment to which our 3.1m members are exposed.
- Finally, commercial lending is by nature, more risky than personal lending. The formation of a centralised vehicle to lend to the SME sector would enable a stronger centralised risk management capability whereby the vehicle, managed by an independent third party, would have dedicated and skilled resources to identify, assess, measure, and manage credit and operational risks. This would facilitate credit unions supporting the commercial loans market, but in a manner that would provide robust mitigants to manage risk, and above all, protect member funds.



"What credit unions seek now is not just another plan, but legislative change to ensure the Minister for Finance has the effective means to deliver on policy and not just titular responsibility for its formulation"
Gerry Thompson
President, ILCU, January 2020

2. Introduction to Irish credit unions

2.1. What is a credit union?

2.1.1. Credit unions are defined[6] as "self-help co-operative financial organisations geared to attaining the economic and social goals of members and wider local communities". Each credit union is governed by its members. The membership elects (from within that membership) unpaid volunteer officers and directors who establish the policies under which the credit union operates. Credit unions typically raise a funding base by accepting savings from their members through shares. Credit unions then lend to their members to assist them in meeting their social and economic goals. Traditionally, loans were generally unsecured, small and for a short term, however more recently, credit unions have expanded into mortgage and commercial lending, but so far at modest levels. At the end of the financial year, a credit union will calculate any surplus or deficit it has on its activities, and pay a dividend as appropriate to its members.

2.2. Ireland's position in a global community

2.2.1. The Irish credit union movement is part of a global movement of credit unions. There are over 85,000 credit unions on 6 continents, active in 108 countries around the world, serving a total membership of 274 million people. The global credit union movement is guided by common operating principles. These operating principles are founded in the philosophy of co-operation and its central values of equality, equity and mutual self-help. Operating principle number 7 states that "credit union services are directed towards improving the economic and social well-being of all members whose needs shall be a permanent and paramount consideration rather than towards the maximising of surpluses".

2.2.2. The Irish League of Credit Unions (ILCU) is the largest credit union representative body on the island of Ireland. Founded in 1960 to provide representation, leadership, co-operation, support and development for credit unions in both Northern Ireland and the Republic of Ireland, the ILCU today has an affiliated membership of 326 credit unions – 234 in the Republic and 92 in the North. Membership of the ILCU is open to every credit union in Ireland.

2.2.3. The Irish credit union movement has been notably active in promulgating the credit union concept in developing economies around the world. The Irish League of Credit Unions International Development Foundation Ltd. (ILCU Foundation) is the charitable arm of the Irish credit union movement and assists the development of credit unions in three countries in Africa: Ethiopia, Sierra Leone and The Gambia, and also provides technical support to credit union movements in Eastern Europe.

2.3. The history of credit unions in Ireland

2.3.1. The Irish credit union movement was founded as a result of the efforts of three dynamic, pioneering and entrepreneurial people namely Nora Herlihy from Ballydesmond, a teacher based in Dublin, Seán Forde, an employee of Peter Kennedy Bakers, Dublin, and Séamus P. MacEoin from Kilkenny, a Civil Servant working in Dublin. In Dublin in the 1950s, they witnessed the effects of high unemployment: sickness, malnutrition, money lending, hunger, poor clothing, poor housing, and inevitably, emigration of one parent or of the whole family. In addition, state unemployment benefits were low and did not last indefinitely leaving many families in abject poverty. The founders recognised the root of the problem as lying in the scarce availability and poor management of money and resolved to identify a system that would allow people to gain more control over their finances. A concept driven by three pioneers became a national movement and culminated with enabling legislation signed into law in 1966 by the then President De Valera. From there, credit unions became recognised and systemic participants in the Irish financial services marketplace.

2.3.2. The development of the credit union movement in Ireland from 1966 was rapid, with credit unions opening in almost all major population centres around the island of Ireland, all driven by civic minded volunteers.

2.3.3. The economic history of credit unions in Ireland is interwoven with the economic history of Ireland from the 1960s to today.

- The credit union movement supported Irish people during the more economically challenging decades of the 1950s to the 1980s. During these periods, the credit union movement played a vital role in supporting the economic and social well-being of Irish people and communities through the provision of small unsecured

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[6] Final Report of the Commission

loans. The ILCU played a key role in providing the support to set up the hundreds of credit unions that were established throughout Ireland during this period.

- The credit union movement grew and prospered during the more benign economic environment from the 1990s to 2008. During this period, as the economic well-being of Ireland improved, so too did the economic well-being of the credit union movement.
- The credit union movement in Ireland is proud of its philosophy of thrift, prudence and economic democracy. One notable feature of the Irish credit union movement is that the ILCU established a self-funded stabilisation scheme (the "Savings Protection Scheme", or more colloquially known as the "SPS"), on the basis of established counter-cyclical economic theories (expressed by the adage that good times are inevitably followed by bad). This then meant that the Irish credit union movement went into the Financial Crisis of 2008 armed with a self-administered fund of €150m. This played a vital role in enabling the credit union movement to endure the stress of the Financial Crisis of 2008, and minimise the need for State intervention, or Exchequer funding.
- The period from 2008 to 2012 did however, place pressures on the Irish credit union movement. The Irish credit union movement is similar to other elements of the financial services landscape, highly sensitive to external economic factors. In times of economic disturbance, lending demand typically falls and arrears typically grow. However, the credit union movement continued to play its vital role during these difficult times, and continued to provide vital credit to Irish people, while at the same time repairing and replenishing their balances sheets, supported by the SPS fund.
- The most recent chapter in the Irish credit union's system is one characterised by reform, transformation and modernisation. On 31 May 2011, the Commission on Credit Unions was established in accordance with the Fine Gael Programme for National Government 2011-2016. Its purposes, were to review the future of the credit union movement in Ireland and make recommendations in relation to the most effective regulatory structure for credit unions, taking into account their not-for-profit mandate, their volunteer ethos, and community focus while paying due regard to the need to fully protect depositors' savings and financial stability. This process culminated with the Credit Union and Co-Operation with Overseas Regulators Act 2012 ("the 2012 Act"), which was signed into law in December 2012. The guiding principle or vision contained in the Commission Report was as follows; in order for the Irish credit union model to mature, a more permissive environment is needed to enable credit unions to offer more services. In order for this permissive environment to be possible, changes are needed to the regulation and governance of credit unions as well as the facilitation of voluntary restructuring of the credit union movement.
- Following this, the governance framework of credit unions was over-hauled. Now credit unions are governed with best in class risk management and strategic frameworks that are aligned to best in class models as promulgated by the OECD. At the same time, the credit union movement underwent a voluntary consolidation process, and the number of credit unions reduced from over 400 (in 2008) to 241 (in 2019).
- Today, Irish people are now served by a smaller pool of stronger and better resourced credit unions.
- This has been coupled with an expansion in services and product capabilities of credit unions. Today, credit unions offer home loans, commercial loans, digital and online account access, payment accounts and many other products that are befitting of a 21st century participant in the financial services marketplace.

2.4. The current "reach" of credit unions

2.4.1. Today, credit unions have a significant footprint in the Republic of Ireland, with a total membership of **3.1 million** people. In line with operating principles, the credit union movement has an interest in improving the economic and social well-being of 3.1 million Irish people.

2.4.2. At 30 September 2019, there were a total of 241 credit unions registered in Ireland, with a combined asset base of €18.3 billion. Members of credit unions are joined by what is referred to as a "common bond". Common bonds in Ireland are typically one of two types: community based (e.g. all those living or working in a specified locality) or industrial (e.g. all those who are employed by a specified employer or organisation). Of Ireland's 241 credit unions, a total of 220 are community based. The 220 credit unions are dispersed in all 26 counties of the Republic of Ireland as follows[7]:

[7] Based on data from the Central Bank of Ireland, Financial Conditions of Credit Unions, December 2019

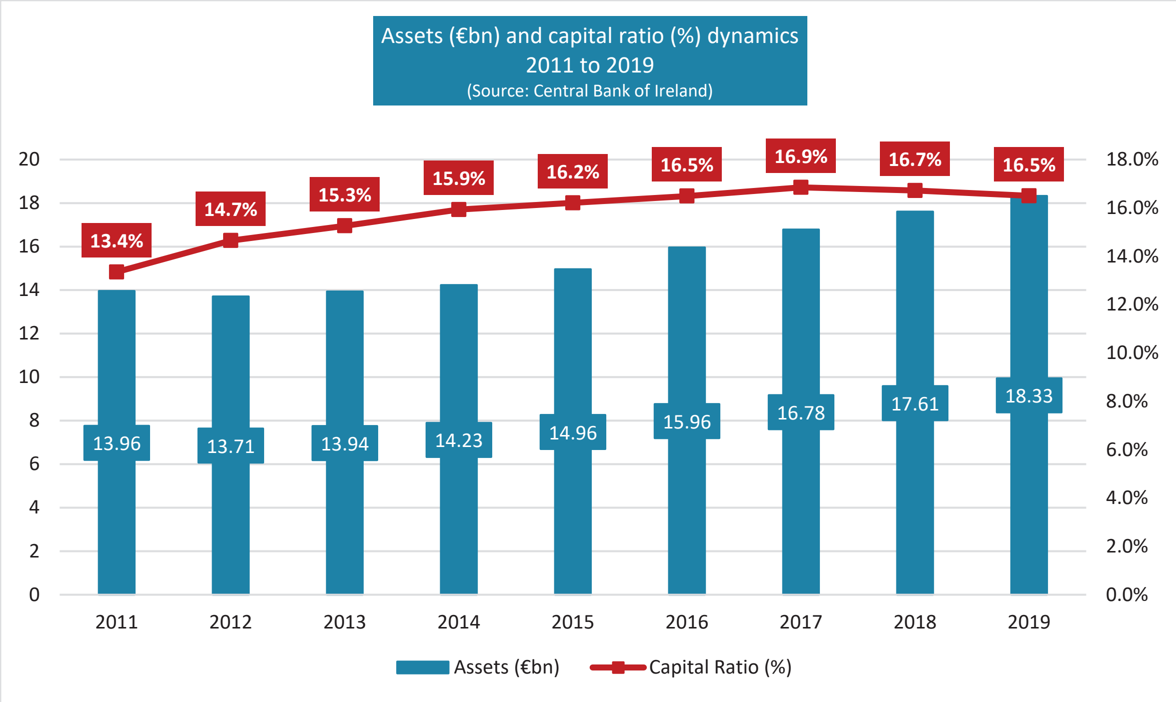
County	Credit Unions
Carlow	3
Cavan	7
Clare	5
Cork	28
Donegal	11
Dublin	35
Galway	11
Kerry	6
Kildare	6
Kilkenny	5
Laois	5
Leitrim	6
Limerick	13
Longford	3
Louth	12
Mayo	7
Meath	10
Monaghan	6
Offaly	5
Roscommon	4
Sligo	3
Tipperary	11
Waterford	7
Westmeath	2
Wexford	5
Wicklow	6
TOTAL	**220**

2.5. Economic overview of credit unions in the Republic of Ireland

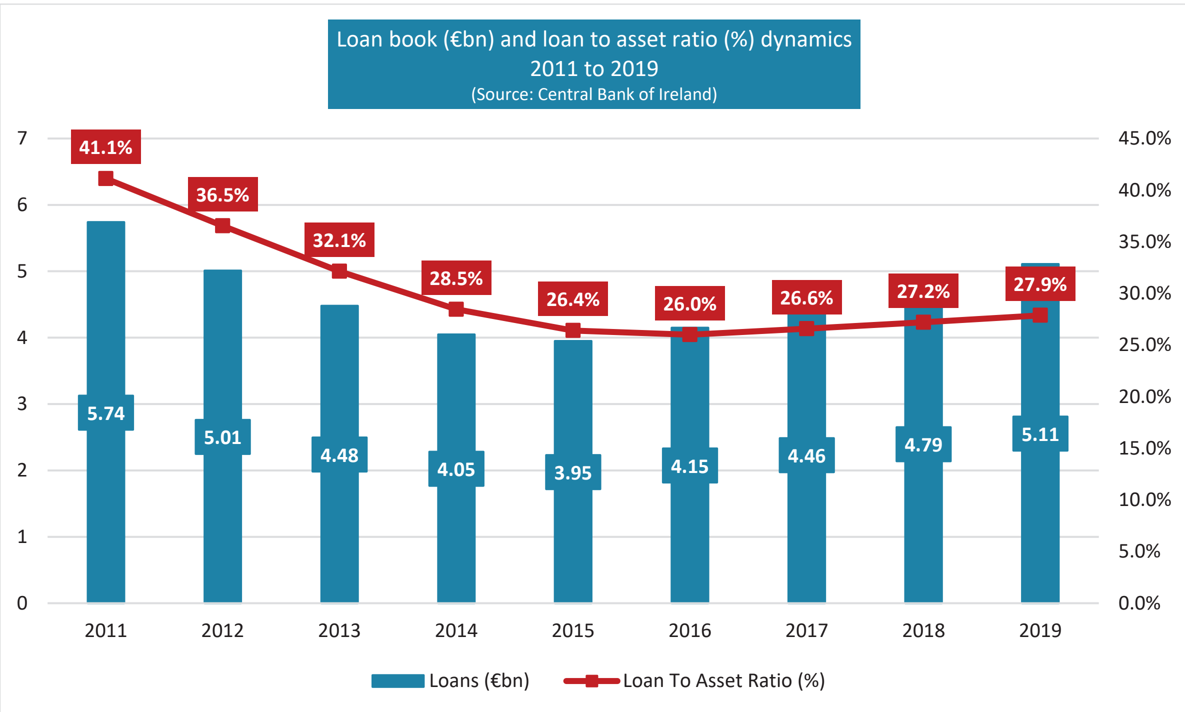
2.5.1. Financial conditions in advanced and emerging economies have been accommodative for a number of years. Accommodative monetary policy is when monetary authorities adopt a policy that boosts money supply and lowers interest rates as a means to stimulate economic activity. This is also called a loose credit or easy money policy, and more colloquially characterised as "Quantitative Easing". In line with the current cycle of accommodative monetary policy in the EU, and Ireland, the current economic environment of credit unions continues to be characterised by two dominant trends: a prolonged low interest rate environment and a continuation of a low lending demand.

2.5.2. The Central Bank of Ireland now publishes regular statistical information relating to Irish credit unions. Highlights from the most recent Financial Conditions of Credit Unions (December 2019) are now set out in graphical format with explanatory commentary.

2.5.3. The Irish credit union movement has grown from an asset base of €14bn to €18bn in the period from 2011 to 2019. During this time, the movement has maintained exceptionally strong capital levels (16.5% in 2019 compared to a general minimum capital rule of 10%).



2.5.4. Similar to other market participants in the EU area, the Irish credit union movement is generally viewed to be under lent. Below, the overall ratio of loan to assets is set out along with the movement wide loan book:



2.5.5. In this regard, of the €18 billion assets of the credit union movement, €5bn of the assets are lent, and €13bn of the assets are not lent out.

2.6. Legal and regulatory environment of credit unions

2.6.1. Enabling legislation for credit unions in Ireland was first passed in 1966 (Credit Union Act 1966). As credit unions grew in scale and complexity, new legislation was passed in 1997 (Credit Union Act 1997). The 1997 Act set out the functions and powers of the Central Bank in relation to credit unions. The functions of the Central Bank are delegated to the Registrar of Credit Unions. The 1997 Act sets out the framework for the registration, regulation, and operation of credit unions. The statutory role of the Central Bank is set out in Section 84 of the Credit Union Act 1997 as follows:

S.84.—(1) The Registrar shall administer the system of regulation

and supervision of credit unions provided for by or under this Act with a view to—
(a) the protection by each credit union of the funds of its members, and
(b) the maintenance of the financial stability and well-being of credit unions generally.

2.6.2. Today, the primary legislation for Irish credit unions remains the Credit Union Act 1997 (as amended). The 1997 Act was significantly amended by the Credit Union and Co-operation with Overseas Regulators Act 2012. It is noteworthy that the 2012 Act created regulation making powers for the Central Bank. Section 29 of the 2012 Act amended Section 84 of the 1997 Act by inserting the following:

(1) In making regulations under this Act the Bank shall have regard to the need to ensure
that the requirements imposed by the regulations so made are effective and proportionate having regard to the nature, scale and complexity of credit unions, or the category or categories of credit unions, to which the regulations will apply.

2.6.3. Following this, on 1 January 2016, section 11 of the 2012 Act was commenced, which substituted a new section 35 in the 1997 Act and provided regulation making powers to the Central Bank. The Central Bank of Ireland has engaged in consultation processes with the credit union movement on a number of occasions on a range of matters since then.

2.6.4. Most recently, the Central Bank of Ireland consulted with the credit union movement on lending via "Consultation Paper 125", or CP125) in late 2018. The Central Bank of Ireland issued the Feedback Statement on CP125 on 21 November 2019, setting out the regulations which were to be commenced at the beginning of 2020. These regulations (the "2019 Regulations") were characterised by the Central Bank as representing "significant and fundamental structural framework changes and will provide sufficient capacity and flexibility to enable safe and sound business model transformation".

2.6.5. The 2019 regulations enabled credit unions to increase business loans to 5% of their assets (with the regulations, in their generality, enabling an extension of limits in certain circumstances). If one was to extrapolate this 5% basic limit to the macro-movement statistics, this means that the credit union movement, in its totality in Ireland, has a basic capacity to issue business loans to a total of **€910m** within the existing regulatory framework. Beyond that, as set out on the previous page, the credit union movement has a much deeper pool of funds at its disposal; a total of €13bn of its total assets of €18bn are not lent.

2.7. The changing landscape of financial services

2.7.1. The financial services landscape has transformed over the past decade; primarily economically and technologically. Like other market participants, Irish credit unions are generally under-lent, and, operating within a prolonged period of low interest rates resulting from the current accommodative monetary policy. Beyond this, traditional channels of delivery are being displaced and disrupted with new innovative market participants. Furthermore, the core demographic and psychographic profile of younger members is changing, with a growing set of needs that are more value oriented and digitally positioned. Movement wide strategy formulation has been adapting to this environment through both imagination and robust financial analysis.

2.7.2. The credit union system in Ireland is addressing the current environmental challenges by endeavouring to diversify into new income streams by creating a digitally enabled compelling value proposition which is economically sustainable in longer term horizons. In achieving this outcome, it is viewed that a collaborative approach to prudent product diversification is a key strategic enabler.

2.7.3. Therefore, while credit unions generally have short term strategies relating to the current business model (growing short term unsecured lending, managing costs, etc.), the "collective" is identifying the need to initiate a more fundamental and substantive "rewiring" of the credit union business model to create a resilient and "Fintech" enabled business model in longer term contexts.

2.7.4. In the Central Bank Guidance Note on Business Model Strategy[8], it was noted that business model sustainability is increasingly dependent on economies of scale and scope, and sectoral collaboration has been a key enabler of business model development internationally. Furthermore, in the Feedback Statement on CP125[9], the Central Bank of Ireland noted that it is supportive of credit unions increasing lending on a

[8] Central Bank of Ireland, February 2019
[9] Central Bank of Ireland, November 2019

prudent basis, including engaging in new areas of lending and increasing exposure to longer term lending as part of a balanced loan portfolio.

2.8. Credit unions in the COVID-19 Emergency

2.8.1. The Irish credit union movement, like every organisation in the Republic of Ireland, has been deeply impacted by the National Emergency which emerged in Ireland with the outbreak of the Coronavirus ("COVID-19") pandemic. COVID-19 presents manifest and immediate risk to public health and human life on the island of Ireland. Arising from this, the Irish Government has taken, and continues to take, a range of extraordinary social and economic interventions in combatting COVID-19 and positioning Ireland to mitigate public health risks. The National Response Plan to COVID-19 is stated to be built on principles of solidarity, reciprocity and care, and calls on Irish citizens to act collectively and enable the Government to deliver a cross-Government and public health-led response, founded on established and evidence-based approaches in dealing with outbreaks of infectious disease. The operating practices of credit unions have changed due to the COVID-19 crisis, and will continue to change looking into the future, in line with public health objectives. The economic impact of COVID-19 is widely reported to be both adverse and significant. The Irish Government, following advice from the National Public Health Emergency Team, on 24 March 2020, listed credit unions as an "essential retail outlet". In this regard, the overarching priority of the Irish credit union movement in the short term has been to ensure continuity of credit union services in Ireland, in a manner that is consistent with public health objectives, throughout the COVID-19 national emergency. In this regard, in the short term, the movement is taking all steps it considers expedient in the social and economic interests of its members, and consistent with national public health objectives and national economic and fiscal policies. The response of the Irish Government to the COVID-19 crisis has played out in real-time and the Government response has required rapid and sudden interventions.

2.8.2. However, in medium to long term contexts, credit unions have a larger role to play in enabling Ireland to respond to the COVID-19 Emergency. COVID-19 has precipitated a severe economic shock that is fundamentally different in nature and scope from types of shocks previously witnessed, and one which is being felt by each and every one of the Irish members of credit unions. Credit unions, around the world, are guided by operating principles that contain values. Credit unions are value driven organisations. Decisions are based on values. The response of the Irish Government to COVID-19 has been founded on values of solidarity, reciprocity and care. On a wider level, globally, COVID-19 has resulted in a dramatic reordering of priorities across organisations. The balance between economic interest, societal interests and public health interests are being recalibrated. Whether the crisis will be seen as a schism in the global ordering of values remains to be seen, but it has led to a period of value-based decisions, where public health is paramount. Operating principle 7 of the global movement is as follows: **"Credit union services are directed towards improving the economic and social well-being of all members, whose needs shall be a permanent and paramount consideration, rather than towards the maximising of surpluses"**. This is the glue that binds credit unions around the world. It defines what credit unions are. Now, as we enter an era of value-based decision making, Operating principle 7 is embedded in the DNA of decision making. The economic and social well-being of our members trumps all. And one area, where the credit union movement feels it can play a national role, is in the provision of finance to small and medium enterprises ("SMEs"), in a rebooting Irish economy.

3. SME Lending

3.1. Introduction to SME lending

3.1.1. "SME" is an acronym for Small and Medium Enterprises. The term is colloquially used to refer to small and medium indigenous businesses. For the purposes of Central Bank analysis and commentary of SME lending, an SME counterparty is defined as any entity engaged in an economic activity, irrespective of legal form (i.e. corporation, partnership, sole-trader, etc.), which employs fewer than 250 persons and whose annual turnover does not exceed €50 million or whose annual balance sheet does not exceed €43 million.

3.2. The importance of SME lending in Ireland

3.2.1. SMEs have played a vital role in the Irish economy. SMEs create employment, generate taxes, stimulate economic activity, and participate in the orderly supply of goods and services for the betterment of the wider population, both domestically and internationally.

3.2.2. In 2019, the OECD[10] (acting through the "OECD Studies on SMEs and Entrepreneurship") issued a report entitled "SME and Entrepreneurship Policy in Ireland". This publication presented an OECD country review of SMEs and entrepreneurship policy in Ireland. It was prepared at the request of the Department for Business, Enterprise and Innovation ("DBEI") in the Irish Government and is part of the series of OECD Country Reviews on SME and Entrepreneurship Policy undertaken by the OECD Centre for Entrepreneurship, SMEs, Regions and Cities.

3.2.3. The report provides a number of objective insights into the nature, scale and national importance of the SME industry in Ireland.

- The OECD noted that SMEs are a "critical pillar of the Irish economy". The OECD reported that there were approximately 250 000 active enterprises in Ireland in 2016, virtually all of them SMEs. Some 92% of enterprises had less than 10 employees (micro), 6.8% had between 10-49 employees (small), 1.2% had 50-249 employees (medium), and only 0.2% had 250 or more employees (large). The share of micro-enterprises is slightly above the OECD average and the share of medium-sized firms somewhat lower than the OECD average. Furthermore, SMEs account for as much as 56% of manufacturing employment and 74% of services employment in Ireland, roughly in line with the OECD averages.
- The OECD noted that Ireland is very successful in generating high-growth firms, which are a key driver of employment, innovation, and productivity growth in the economy. SMEs in Ireland participate in mixed modes of innovation. Furthermore, Irish SMEs display the third-highest share of new-to-market production innovation in OECD economies. The SME share of business R&D in Ireland stood at almost 40% in 2015, above the OECD average of 35% (OECD, 2017).
- The OECD noted that the share of Ireland's adult population with high regard for successful entrepreneurs is above the OECD average, whilst other indicators of entrepreneurial attitudes lie around the OECD average, as shown in Figure 1.7. On the other hand, less than half of the people (42%) who perceive opportunities believe they have the skills and knowledge required to start a business.
- The OECD noted that business start-up rates vary significantly across Ireland. The start-up rates are the highest in Dublin and Cork, and are significantly lower in the rest of the country. SME innovation rates show a similar core periphery pattern. These variations appear to reflect a number of differences in the quality of local entrepreneurship ecosystems across Ireland in terms of the degree to which they provide favourable institutional support and access to resources conditions.

3.3. Financing of SMEs

3.3.1. The primary finance providers to SMEs in Ireland are the main retail banks[11], non-bank finance providers, the Credit Union sector, and State bodies and policy initiatives put in place to support and facilitate SME access to finance.

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[10] The Organisation for Economic Co-operation and Development

[11] Bank of Ireland, AIB, Permanent TSB, Ulster Bank and KBC

3.3.2. The Central Bank of Ireland issues an annual "SME Market Report" which provides a summary of developments in the provision of credit to SMEs by financial intermediaries. The most recent report[12] contained the following highlights:

- €15.5 billon of credit outstanding to non-financial non real estate SMEs in Q4 FY2018
- 90.3% of new lending market share among the top three lenders
- 20% application rate for bank finance
- 8.5% share of SMEs applying for credit for working capital in September 2018
- 15% bank finance rejection rates in September 2018
- 5.7% interest rate for non-financial corporation loans of less than €0.25m in January 2019
- 17.5% share of SME loans in default, weighted by loan size, as of Q2 2018.

3.3.3. Following the Financial Crisis that commenced in 2008, a number of state policy supports were put in place to address the perceived market failure in the Irish banking and financial services market. These include:

- Strategic Banking Corporation of Ireland ("SBCI"): The SBCI operates a number of schemes on behalf of the DBEI and the Department of Agriculture, Food and the Marine. These include the Brexit Loan Scheme, the Future Growth Loan Scheme and the SME Credit Guarantee Scheme. The SME Credit Guarantee Scheme (CGS) is operated by the SBCI, on behalf of DBEI. Loan facilities are available to eligible SMEs for terms of up to seven years for amounts ranging between €10,000 and €1 million.
- Microfinance Ireland: Microfinance Ireland is a not-for-profit lender that provides small loans of up to €25,000 to small businesses with fewer than 10 employees and annual turnover of less than €2 million.
- Local Enterprise Offices and Enterprise Ireland: Local Enterprise Offices ("LEO"s) offer a range of supports including: advice, feasibility study grants, technical assistance for micro exporters ("TAME"), priming grants, business expansion grants and microfinance loans. Enterprise Ireland also offer supports for companies at different stages of their development.
- Credit Review Office: The Credit Review Office was established in 2010 by the Government, in order to provide a review process for SMEs and other enterprises who are refused credit by banks participating in the NAMA scheme.

3.3.4. In this regard, the SME lending market is dynamic and subject to many policy interventions by the State.

3.4. The devastating impact of COVID-19 on SMEs

3.4.1. The impact of the COVID-19 pandemic on the global economy has been severe. The pandemic outbreak and the measures required to contain its spread, have brought global markets to a near standstill, triggering a very sudden and sharp contraction in economic activity globally, nationally and locally. The entire spectrum of economic activity in Ireland has been impacted in varying measures. In its Quarterly Economic Bulletin, the Central Bank of Ireland[13] commented that:

- COVID-19 has triggered an extremely severe economic shock that is fundamentally different in nature and scope from types of shocks previously witnessed.
- The speed with which economies have, effectively, come to a sudden stop is unprecedented and a global health pandemic has become a global economic crisis.
- For the Irish economy, this has resulted in the widespread shutdown of businesses, mainly in the market services sectors of the economy, with labour-intensive sectors, such as retail trade, food and beverage activities and accommodation, tourism and travel, particularly affected. By end-March, the numbers on the Live Register, combined with those in receipt of Covid-19 related payments, had risen to over 500,000, with further job losses expected.
- Given the unprecedented nature of this crisis, the outlook is characterised by an extreme degree of uncertainty. The future path of the pandemic, in particular its scale and duration, is unknown, and, as a consequence, so is the duration and scope of the containment measures. As a result, there is considerable uncertainty about both the potential depth and persistence of the downturn currently underway, and also the likely timing and speed of an eventual recovery.

3.4.2. SMEs in Ireland are part of this economic narrative. The speed, suddenness and severity of the global economic shutdown has left, what were thriving small and medium sized businesses throughout Ireland pre COVID-19, utterly paralysed. The Nobel Prize-winning economist and New York Times columnist, Paul Krugman, likened the economic shutdown to a coma; "…this isn't a conventional recession; it's more like a medically

[12] SME Market Report 2019, Central Bank of Ireland
[13] Central Bank of Ireland, April 2020

induced coma, where you temporarily shut down much of the brain's activity to give it a chance to heal"[14]. In this regard, positioning SMEs in Ireland to once again, thrive, in a post COVID-19 Emergency, when awoken from the coma, is a matter of public interest.

3.4.3. The National Response Plan to the COVID-19[15] Emergency is built on principles of solidarity, reciprocity and care. The National Response Plan to the COVID-19 Emergency calls on Irish citizens to act collectively. The National Response Plan calls on everyone to play his or her part in combatting COVID-19. The National Response Plan to the COVID-19 Emergency states that solidarity, cohesion and determination on the part of everyone will assist in limiting the spread of this virus and protect the nation. The National Response Plan states that voluntary and community organisations are at the heart of the State's co-ordinated response to COVID-19, in caring for each other.

3.4.4. The Irish credit union movement is a voluntary community organisation. The Irish credit union movement has €18bn in assets and €3bn in reserves. The Irish credit union movement has multiple outlets in each and every county, with a touchpoint on 3.1m Irish citizens. The Irish credit union movement has backed both the Irish economy and Irish society from the 1950s. Credit unions are value-based organisations. Credit unions have a role to play in the National Response to COVID-19. This is the context in which our response to COVID-19 is set. When the Irish economy wakes from the "Krugman Coma", credit unions will be ready, willing and able to play a role, and serve the common good.

14 @paulkrugman, Twitter ©

15 Department of the Taoiseach, 16 March 2020

4. A credit union vehicle to support SME lending

4.1. Public banking context

4.1.1. The Programme for a Partnership Government contained a commitment to investigate the Sparkassen model of local public banks that operate within well-defined regions. This commitment was fulfilled by the Department of Finance and the Department of Rural and Community Development with the publication of the joint report on 'Local Public Banking in Ireland'[16]. In this report, the key conclusions included:

> "The results of the investigation into local public banking indicate that, given the current demand for and supply of credit, there is not a compelling business case for the State to establish a new local public banking system based on either the Sparkassen or Kiwibank model by drawing on Exchequer funding. However, there is no impediment to engaging with the Central Bank of Ireland, the credit union sector, An Post or any other private sector entity/investor in relation to their proposal. It is open to them to progress their proposal on this basis in a manner that does not involve State funding".

4.1.2. In addition, the Government agreed that the Department of Finance would commission an independent external evaluation of how the local community banking concept may be furthered in other ways. Following this, in 2019, the Department of Finance engaged Indecon International Economic Consultants ("Indecon"), to undertake an independent evaluation of how the concept and objectives of community banking, and local provision of banking and financial services, may be furthered in Ireland.

4.1.3. Indecon reached a similar conclusion to the Department of Finance and the Department of Rural and Community Development report. Indecon noted that a distinctive feature of the Irish local financial services market is the role played by the credit union movement. Indecon believes that credit unions are critical elements of community banking and recommended that the Department of Finance should support the credit union movement to deliver an expanded range of community banking services. In particular, the Indecon Report concluded that:

> "The existing financial services sector in Ireland includes commercial banks as well as credit unions, An Post, and other providers. Indecon believes there is scope for the delivery of an expanding range of local financial services via the existing networks. Of particular importance are the recent initiatives taken by the credit union movement as well as the plans by An Post to expand the services provided. There is also an ongoing role for the main banking groups to help overcome information asymmetries and to ensure that viable micro-firms and SMEs are facilitated to secure credit. ….Some adjustments to the existing state supports could be made to further the provision of local banking services. Using the existing programme infrastructure would represent a cost-effective way of enhancing access to finance"

4.1.4. In January 2020, the Irish League of Credit Unions issued "Credit Unions 2020 Vision" a paper summarising policy priorities geared to align developmental policy for credit unions with effective regulatory oversight. Our 2020 Vision emphasises that credit unions are not simply an alternative to banks. Our movement is a model of community banking with deep roots and widespread affinity that is the basis not just for what we do now, but for delivering a much wider range of services as well.

4.1.5. In this context, the following can be reasonably stated:

- Credit unions are recognised as a de facto form of community banking service provider in Ireland.
- Ireland is now in the midst of a national emergency.
- The credit union movement, as a community based organisation, wishes to respond to the government call and play a part in a co-ordinated response in line with our 2020 Vision.

4.1.6. The proposed SME support model is set in this context.

[16] **Local Public Banking in Ireland** - An analysis of a model for developing a system of local public banking in Ireland, 2018. See Department of Finance Website

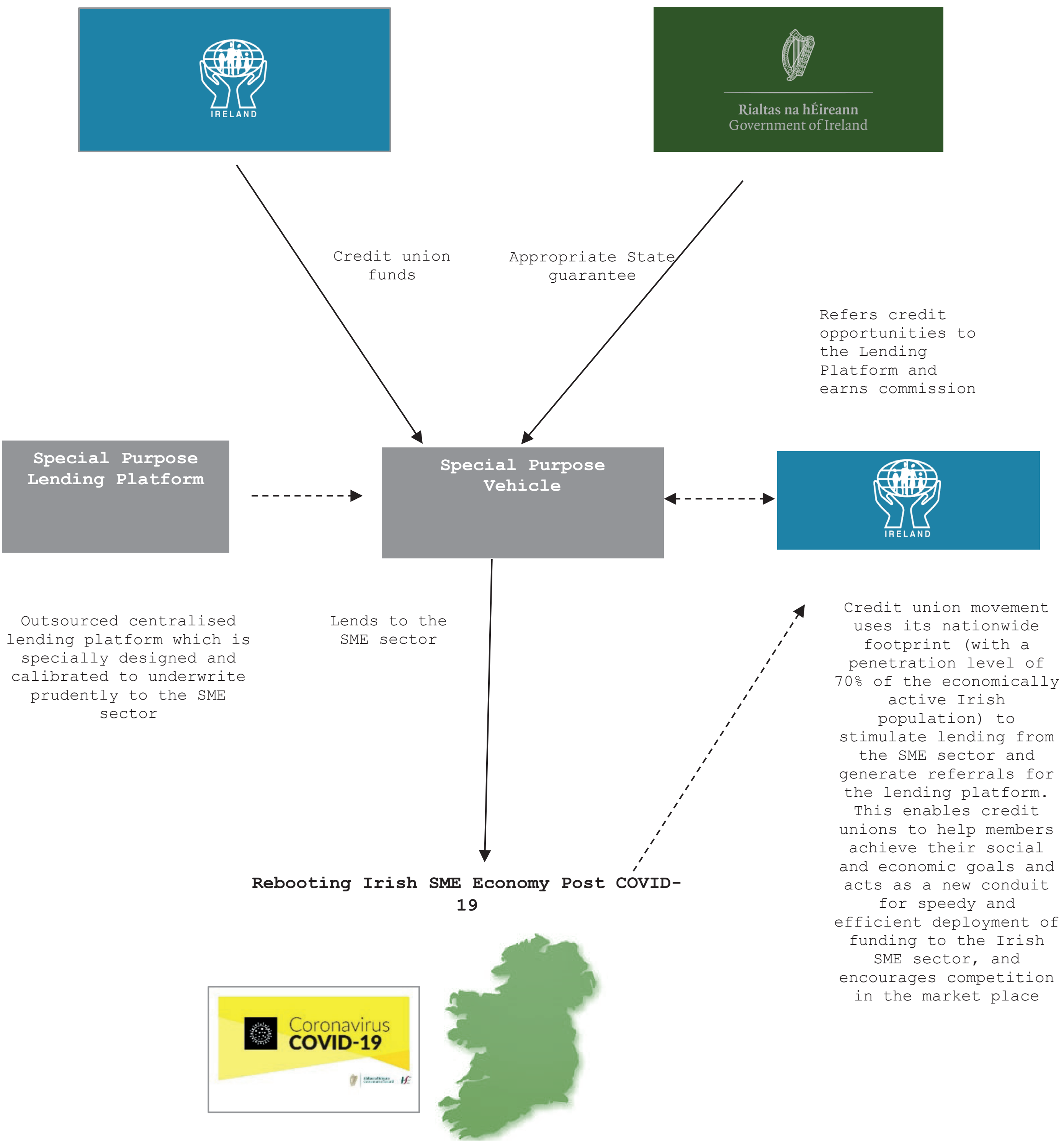
4.2. Our proposition

4.2.1. Our proposition is broadly as follows; Irish credit unions would participate in a State-backed vehicle that would:

- Enable Irish credit unions to act as an efficient distribution network to originate SME loan applications, in a post COVID-19 environment
- Enable Irish credit unions to invest in a funding facility that will lend to SMEs in Ireland.

4.2.2. We recognise that credit unions can, through the 2019 Regulations, inject 5% to 10% of their assets into SME lending. Our proposition is to go beyond this, and use a greater level of our €18bn in assets to stimulate a rebooted Irish economy.

4.2.3. An infographic setting out an outline of the proposal is shown below:



4.2.4. The **benefits for the State** of this proposal are set out below:

- Credit unions have an unparalleled reach within Irish communities. In a post COVID-19 world, the economy will need to be rebooted at speed, with all necessary supports. SMEs will require credit to rebuild their businesses. A structured credit union investment vehicle would enable the rapid infusion of credit into SMEs in all major population centres in the country. Credit unions are located throughout the country and interface with a significant portion of the economically active population of Ireland. Credit unions are different in structure, nature and ethos to retail banks. The credit union model could act as a new conduit for the State to stimulate borrowing in the SME market and support it with competitive loans in a speedy and effective manner, using the credit unions' pre-existing and mature infrastructure. The credit union movement has a wide socio-economic and political reach. Thousands of civic minded volunteers committed to furthering the social and economic goals of 3.1m people within the Irish State, are active in local communities and could provide a key link to the SME sector in communicating the availability of funding at grass-roots level.
- The vehicle would open up a far greater portion of the credit union movement's €18bn in assets. Current regulations limit business lending to between 5% and 10% of assets. A state-backed investment vehicle would open up a far greater level of funds for Irish SMEs, in a prudent and sensible manner. The movement has substantial funds that are not lent, and these funds are currently economically and socially redundant.
- The proposal would also enhance competition in the market place.

4.2.5. The **benefits** of this proposal **for the credit union movement** are set out below:

- The key benefit arising for the credit union movement from the proposal would be that it would enable the movement to put a greater portion of its asset base, **€18bn**, to a more productive and economically rewarding purpose, at a time of national crisis. The proposal is built on principles of solidarity, reciprocity and care, and it enables the credit union movement to answer the Government call to act collectively, and enable the Government to deliver a cross-Government and public health-led response.
- Credit unions, by definition, exist to assist their members to attain their economic and social goals. On a wider economic level, the Irish credit union movement is, similar to other elements of the financial services landscape, highly sensitive to external economic factors. Given the economic importance of SMEs to the overall well-being of the wider economy, the Irish credit union movement has a strategic interest in supporting the SME sector as this should lead to a strengthening of the economic environment to which our 3.1m members are exposed.
- Finally, commercial lending is by nature, more risky than personal lending. The formation of a centralised vehicle to lend to the SME sector would enable a stronger centralised risk management capability whereby the vehicle, managed by an independent third party, would have dedicated and skilled resources to identify, assess, measure, and manage credit and operational risks. This would facilitate credit unions supporting the commercial loans market, but in a manner that would provide robust mitigants to manage risk, and above all, protect member funds.

5. Regulatory framework

5.1. Current regulatory framework as it relates to investments

5.1.1. The Credit Union Act 1997 (as amended) creates regulation making powers for the Central Bank of Ireland on the types of investments that a credit union may invest members' funds in.

5.1.2. Section 43(3) of the 1997 Act sets out as follows:

> For the purposes of subsection (2)(c) the Bank may prescribe investments in which a credit union may invest its funds. In prescribing matters for the purposes of subsection (2) and having regard to the need to avoid undue risk to members' savings, the Bank may also prescribe other matters in relation to prescribed investments, including any of the following: (a) the classes of investments, including, where appropriate, any investment project of a public nature the credit union may invest in; (b) the quality of investments and quality of counterparties that the credit union may invest in; (c) the maximum, including percentage, amount (by reference to a credit union's surplus funds to which subsection (2) relates or otherwise) of a class of investments that may be invested in; (d) the term to maturity of a class of investments; (e) the currency of a class of investments; (f) limits for investment, whether by reference to maturity, currency, counterparty, sector, instrument or otherwise; (g) any other matters that the Bank may consider necessary in the circumstances.

5.1.3. Pursuant to this, the Central Bank of Ireland has created regulations[17] to prescribe investments as follows (in Regulation 25 of 2018).

25. (1) A credit union may only invest in euro denominated investments in the following:

(a) Irish and EEA State Securities;
(b) supranational bonds;
(c) accounts in credit institutions;
(d) bank bonds;
(e) corporate bonds;
(f) regulated investment vehicles where the underlying investments of the regulated investment vehicle are investments in Tier 3 Approved Housing Bodies;
(g) UCITS;
(h) shares of, and deposits with, other credit unions;
(i) shares of a society registered under the Industrial and Provident Societies Act 1893 to 1978, provided the society is not an approved housing body.

(2) For the purposes of Regulation 25(1)(f), the underlying investments of a regulated investment vehicle in a Tier 3 Approved Housing Body shall consist exclusively of loans or other forms of debt financing provided by the regulated investment vehicle to the Tier 3 Approved Housing Body.

5.2. Our request

5.2.1. In order for Irish credit unions to invest in a special purpose vehicle to fund SMEs in a post COVID-19 environment, Regulation 25 of the 2018 Regulations would need to be expanded to include a SME-oriented SPV.

5.2.2. This change in regulation, would free up billions of funds to be lent to SMEs in Ireland, in a prudent and progressive manner, and ultimately assist the Government in its response to COVID-19. This would result in a policy measure that would act as a major stimulant to the re-booting of the Irish economy, by a movement that has dutifully served the Irish economy for over 60 years.

[17] Credit Union Act 1997 (Regulatory Requirements) Amendment Regulations 2018, (S.I. No. 32 of 2018)