Policy Paper

Common Bond

Credit Union Advisory Committee

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Contents

1. Purpose of the Paper

This paper considers the value of the common bond and whether or not it still remains relevant to all credit unions in meeting the needs of their members. As recommended by the Credit Union Advisory Committee (CUAC) in its 2016 Report, in reviewing the common bond, account will be taken of international experience and of CUAC's Credit Union Survey 2017 which provides views of individual credit unions, in forming opinions and providing options.

2. Background to the Paper

CUAC in its 2016 Review of Implementation of the Recommendations in the Commission on Credit Unions Report, made a number of recommendations. CUAC also noted that the common bond as currently defined may place limits on the potential for credit union product and service growth. CUAC further noted that this may result in some members being able to avail of only a limited product range from their credit union. CUAC recommended that the common bond be subject to detailed consideration, taking account of international experience and in consultation with stakeholders to develop a policy paper on this matter.

In 2017 CUAC carried out a Survey of Credit Unions. One area of the questionnaire focussed specifically on the common bond. While the topic of the common bond has arisen over the years and discussions have taken place, no changes have been made to the operation of the common bond to date. Previous references to the common bond are as follows:

- ### Commission on Credit Unions

The matter of the common bond was raised in the Commission on Credit Unions Report (2012). The result of the Commissions survey showed that 53.6% of sector wide respondents wanted no change in the common bond; 19.9% considered that membership should come from several common bonds; and 26.5% would consider that membership should be open to anyone who wants to join. Based on these results, the Commission concluded that following consultation with the sector, it did not consider that a compelling case for fundamental change to the common bond had been made.[1]

[1] Report of the Commission on Credit Unions. March 2012. Chapter 7 Ref:7.9.3

- **CUAC Credit Union Survey 2016**

CUAC conducted a general survey of credit unions in April 2016.[2] There were 101 credit union responses. One question asked credit unions to rank potential constraints on development of their credit union. There were 21 constraints listed. The common bond was ranked number 18 with 21% stating that it is extremely important as a potential constraint and 23% citing it as quite important as a potential constraint.

- **CUAC Credit Union Survey 2017**

In 2017 CUAC conducted a credit union survey specifically to obtain credit union opinions and views in relation to three areas in which CUAC's 2016 Report recommended that policy papers be developed. These areas were Voting; Interest Rate; and the Common Bond. This paper utilises the results of the 2017 Survey in identifying credit unions views and in making recommendations regarding the common bond.

3. Common Bond

Common bond requirements are set out in legislation - section 6 of the Credit Union Act 1997[3]. Credit unions in Ireland cannot do business with the general public due to charter limitations based on serving a membership that is characterised by a common bond, which is founded on a pre-existing social connection, such as belonging to a particular community, industrial or geographic group.[4] The common bond is considered an explicit characteristic which distinguishes credit unions from other financial institutions.

Section 5 of the Standard Rules for Credit Unions sets out membership limitations for each specific credit union. Rule 11 sets out, in writing, requirements which each member must comply with to be admitted as a member to that particular credit union.

In the past when there were no real formal systems and processes whereby loan applications could be accurately assessed, the common bond served to facilitate and assist in this process by enabling credit judgements to be made on character and personal record, as well as on commercial risk factors. The common bond is intended to circumvent problems of imperfect information, which are inherent in

[2] A Survey of Irish Credit Unions. Credit union Advisory Committee. April 2016. (Pg. 10)
[3] Appendix I – S6 Credit Union Act 1997
[4] Report of the Commission on Credit Unions. March 2012. Chapter 2 Ref:2.2.1

many financial transactions. Most common bonds in Ireland are relatively tightly defined and are community-based. A credit union can amend its common bond but this must be done within the parameters set out in legislation. In August 2017 the Registrar of Credit Unions (RCU) issued an Explanatory Note on a credit union amending its common bond and an e-mail also issued from the Central Bank to all credit unions in this regard.[5]

The common bond is part of the democratic structure of a credit union and so discussions around this topic can be contentious, given that some credit unions are reluctant to make any change to its basic structure. This contrasts with the position in many other countries (Canada, US and UK) where the common bond tends to be much more loosely defined.

4. Other Jurisdictions

It is accepted that credit unions worldwide have developed at different rates and can be classified in terms of the developmental typology (nascent, transition and mature).[6] Such development has affected the common bond in various ways. While in some jurisdictions the credit union common bond continues to be very clearly defined, other jurisdictions, typically those with credit unions at maturity stage e.g. US and Canada, have a looser or a less defined common bond. The rules of a credit union determine its common bond. As part of this study CUAC considers how the common bond has developed in other jurisdictions.

- ### UK (GB and NI)

A number of changes have taken place in GB regarding the operation of the common bond. In 1996 reforms were introduced, one of which was to allow credit unions increase the scope of their existing common bonds. When the Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011 was introduced it brought changes to the common bond in 2012. These changes included a reduction in the restrictions on credit union membership by reforming common bond regulations and also permitting groups as well as individuals to become members. This has enabled credit unions to reach out to new groups by serving more than one group of people. Credit unions can provide services to community groups, businesses and co-operatives as well as individuals, including different groups of people within one credit union.

[5] Explanatory Note: on amendment of a credit union common bond -https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/credit-unions/amendments-processing/explanatory-note.pdf?sfvrsn=4
[6] See Ferguson and McKillop (1997).

There are still four types of common bond: following a particular occupation; being employed by a particular employer; residing or being employed in a particular locality; or being a member of a bona fide organisation or being "otherwise associated." Members can now vote to accept common bond changes but they must also be accepted by regulating bodies such as the Financial Conduct Authority and the Prudential Regulation Authority.[7] The legislation facilitated, not only the extension of services to new groups of people, but also enabled the making of partnerships with bodies such as housing associations, charities and employers.

In Northern Ireland (NI) the Credit Unions and Co-operative and Community Benefit Societies Act (Northern Ireland) 2016 came into force in April 2016. Among the changes brought by this Act was to allow credit unions to admit corporate members and to remove the current statutory 10% limit on non-qualifying members.

- **Canada**

The credit union movement in Canada is keeping pace with product and service developments in Canada's financial services sector. Technological changes continue to push the credit union movement to re-evaluate the most appropriate method of delivering services to its members.[8] Legislative amendments made in 2012 embed internationally recognised cooperative principles for credit unions, including: each member has one vote; services are primarily for members; and membership is open but bonds of association (i.e. based on a common workplace) are permitted.[9]

- **US**

Every US credit union is organised around a field or fields of membership shared by members. A field of membership can consist of any one of the following:

i. A single group of individuals who share a common bond;
ii. More than one group, each of which consists of individuals sharing a common bond;
iii. Or a geographical community

Common bonds are either occupational (employees of a firm), associational (members of an association, such as a religious or fraternal organisation), or geographical (all individuals who live, work, attend school or worship within a defined community).

[7] CO-OP News Website https://www.thenews.coop/96095/sector/credit-unions/whats-common-british-credit-unions/
[8] Department of Finance Canada https://web.archive.org/web/20090304175302/http://www.fin.gc.ca/toc/2000/ccu_-eng.asp
[9] Department of Finance Canada http://www.fin.gc.ca/n12/data/12-174_1-eng.asp

US credit unions may be typically chartered to serve a specific employee or associational group or groups (Select Employee Group – SEG Charter), all members of a trade, industry or profession (TIP Charter), or have a Community Charter (typically a field of membership of anyone who lives, works, goes to school, or attends religious services in a particular city, county or counties).

- **Comment**

It can be seen from these examples that over recent years changes have been made to the common bond in other jurisdictions. In GB the common bond has some flexibility in that membership of those other than individuals is now permitted. Canadian credit unions still retain a common bond structure, however, it is no longer necessary for members to belong to a common bond. It must also be noted that where changes have been made to the common bond they were not made in isolation but as part of a package of measures across a number of areas, including interest rate increases.

5. Views around the Common Bond – CUAC Stakeholder Discussions

In its discussions with stakeholders, as part of its review, CUAC documented the views of six individual credit unions, credit union representative bodies, Credit Union Restructuring Board (ReBo) and the Central Bank. Views regarding the common bond are briefly outlined here:

- **Individual Credit Unions**

The matter of the common bond was raised by three credit unions in relation to business model development. One medium sized credit union remarked that marketing in a tight common bond is affecting the business model, and the fact that 30% of its younger members now reside outside the area is also challenging. It was suggested that an opening up of the common bond would provide a new lease of life to credit unions. The common bond was flagged by a number of credit unions as an area needing to be looked at again.

- **Representative Bodies**

The two main credit union representative bodies have differing views on the common bond, with the ILCU currently not in favour of change being introduced to the way in which it operates. CUDA on the other hand considers that it should be looked at again and changed or abolished given that it is not appropriate to today's Irish credit unions in trying to develop their business models.[10]

- ReBo

ReBo considered that the relevance of the common bond has now changed, due to restructuring. It further stated that it should not matter where a person lives or works, as a person should be able to join any credit union that will accept them as a member.

- Central Bank

The Central Bank highlighted that it was not for them to be definitive in relation to any proposed changes to the common bond. It was indicated that in the context of restructuring, some credit unions required rule changes to enable completion of the process. However, it was pointed out that any rule changes made had to fit with section 6 of the 1997 Act. This required a commonality of interests in the existing common bond and any new proposal.

[10]CUDA made a further submission to CUAC in July 2017 seeking consideration of three enhancements to the common bond.

6. Credit Union Survey 2017

CUAC conducted a credit union survey in May/June 2017. While 138 responses were received overall, 107 responses were received in relation to the common bond. Information is presented in Tables 1, 2 and 3 by five asset size categorisations and by common bond type (community common bond and industrial common bond).

Table 1

COMMON BOND	(a) Do you believe that a change is required to the Common Bond arrangements?				(b) Do you believe that the Common Bond is restricting your business growth potential?				(c) Do you believe that the Common Bond is a protectionism for your Credit union?				(d) Do you believe that the Common Bond should be fully removed?			
	Yes	No	Don't Know	Total	Yes	No	Don't Know	Total	Yes	No	Don't Know	Total	Yes	No	Don't Know	Total
Community																
<€20m	9	9	0	18	10	9	0	19	8	9	1	18	5	13	1	19
€20m - €40m	11	15	1	27	12	14	1	27	19	7	0	26	3	22	2	27
€40m - €60m	10	6	2	18	9	9	0	18	10	7	1	18	5	12	1	18
€60m - €100m	3	3	2	8	3	5	0	8	5	3	0	8	1	5	1	7
>€100m	22	4	1	27	17	9	0	26	11	16	0	27	10	16	1	27
Total	55	37	6	98	51	46	1	98	53	42	2	97	24	68	6	98
Industrial																
<€20m	1	0	0	1	1	0	0	1	1	0	0	1	0	1	0	1
€20m - €40m	1	1	0	2	1	1	0	2	1	0	1	2	0	2	0	2
€40m - €60m	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
€60m - €100m	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
>€100m	3	2	1	6	3	3	0	6	4	2	0	6	2	3	1	6
Total	5	3	1	9	5	4	0	9	6	2	1	9	2	6	1	9
All Credit Unions																
<€20m	10	9	0	19	11	9	0	20	9	9	1	19	5	14	1	20
€20m - €40m	12	16	1	29	13	15	1	29	20	7	1	28	3	24	2	29
€40m - €60m	10	6	2	18	9	9	0	18	10	7	1	18	5	12	1	18
€60m - €100m	3	3	2	8	3	5	0	8	5	3	0	8	1	5	1	7
>€100m	25	6	2	33	20	12	0	32	15	18	0	33	12	19	2	33
Total	60	40	7	107	56	50	1	107	59	44	3	106	26	74	7	107

Table 1 captures information on four questions (a) *do you believe that a change is required to the common bond arrangements?* (b) *do you believe that the common bond is restricting your business growth potential?* (c) *do you believe that the common bond is a protectionism for your credit union?* (d) *do you believe that the common bond should be fully removed?*

It can be seen from Table 1 that over 91% of responses received were from Community credit unions. Of the Community credit unions that responded, in relation to each of the 4 questions, circa 65% of respondents had assets of less than €60m.

In relation to part (a) 57% of Community credit unions believe that change is required in the common bond arrangements while 38% believe that no change is required, which is consistent with results for

Industrial credit unions where 56% believe that change is required while 33% believe it is not. It is interesting to note that 53% of those credit unions (Community and Industrial) that believe there should be some change in the common bond were credit unions with assets of €60m or less.

Part (b) asks if the common bond is restricting business growth potential. Results for both Community and Industrial credit unions are very balanced with 52% of Community credit unions answering yes to this and 47% answering no. This compares with a response of 56% yes and 44% no for Industrial credit unions.

Part (c) asks if the common bond is a protectionism for your credit union. 55% of Community credit unions stated yes and 43% said no, whereas 67% of Industrial credit unions said yes and 22% said no.

Part (d) asks if the common bond should be fully removed. There was an emphatic 'no' from both types of credit union, with 69% of Community credit unions and 67% of Industrial credit unions saying no. Responses were similar across credit unions of all asset sizes with a majority in each asset class believing that the common bond should not be fully removed.

Overall responses, from both Community and Industrial credit unions were as follows:

- Circa 56% of respondents believe that a change is required to the common bond arrangements, while circa 69% believe that the common bond should not be fully removed.
- While circa 52% believe that the common bond is restricting business growth potential, almost 47% believe that it does not restrict it.
- In relation to protectionism, circa 56% believe the common bond is a protectionism, while circa 42% believe it is not. 66% of respondent Industrial credit unions believe that it is a protectionism.
- In answer to the question should the common bond be fully removed, overall 69% of credit unions said it should not be fully removed while 24% believe that it should be fully removed.

In a follow up question respondents were asked *what change(s) if any, do you believe should occur to the Common Bond arrangements?* There were 60 responses to this question and the responses can be summarised as follows:

- 19 (32%) responded that there was a need for a more open/flexible common bond or for a relaxation of the common bond. A further 10 (17%) commented that there was a need for various types of change within the common bond. This amounts to 49% seeking a specific type of change to the common bond.

- 7 (12%) commented that the common bond should be fully removed.
- These responses show that 61% of respondents either want a change to the common bond or want it fully removed.
- 14 (23%) stated that they did not want any change to the common bond.
- There were 10 general comments regarding the current operation of the common bond e.g. better communication around the common bond, clarity needed, explain what the common bond is.

Respondents were then asked *what is your best estimate of your membership penetration into your common bond?* There were 107 responses which are set out in Table 2. A significant number of credit unions appear to have significant scope for expansion within their existing common bond. For example, 3% of credit unions considered membership penetration to be less than 20%, approximately 23% considered it to be 20 - 40%, while 36% believed that membership penetration was 40-60%.

Table 2						
COMMON BOND	What is your best estimate of your membership penetration into you Common Bond?					
Penetration Rate	<20%	20% - 40%	40% - 60%	60% - 80%	80% - 100%	Total
Community						
<€20m	1	7	11	0	0	19
€20m - €40m	0	8	10	5	2	25
€40m - €60m	0	3	4	9	3	19
€60m - €100m	0	0	1	7	0	8
>€100m	1	4	9	9	4	27
Total	2	22	35	30	9	98
Industrial						
<€20m	0	0	1	0	0	1
€20m - €40m	0	1	1	0	0	2
€40m - €60m	0	0	0	0	0	0
€60m - €100m	0	0	0	0	0	0
>€100m	1	2	1	1	1	6
Total	1	3	3	1	1	9
All Credit Unions						
<€20m	1	7	12	0	0	20
€20m - €40m	0	9	11	5	2	27
€40m - €60m	0	3	4	9	3	19
€60m - €100m	0	0	1	7	0	8
>€100m	2	6	10	10	5	33
Total	3	25	38	31	10	107

Respondents were asked what would be an appropriate timeframe in which to make changes to the common bond, where you believe that changes should be made? There were 83 responses to this question and they are documented in Table 3. As can be seen from Table 3, a majority (54%) of those that sought change wanted change to occur within two years.

Table 3				
COMMON BOND	Where you believe that changes should be made to the Common Bond, what do you consider an appropriate timeframe in which to make those changes?			
Proposed Timeframe	< 2 years	2-5 years	> 5 years	Total
Community				
<€20m	9	5	0	14
€20m - €40m	8	8	1	17
€40m - €60m	8	7	0	15
€60m - €100m	3	2	0	5
>€100m	14	11	1	26
Total	42	33	2	77
Industrial				
<€20m	0	1	0	1
€20m - €40m	0	1	0	1
€40m - €60m	0	0	0	0
€60m - €100m	0	0	0	0
>€100m	3	1	0	4
Total	3	3	0	6
All Credit Unions				
<€20m	9	6	0	15
€20m - €40m	8	9	1	18
€40m - €60m	8	7	0	15
€60m - €100m	3	2	0	5
>€100m	17	12	1	30
Total	45	36	2	83

7. Credit Union Sector Developments

It is recognised that in the past, the common bond requirements helped in the absence of more formal systems of credit bureaux to assist with assessment of loan applications. However, it has been identified that the common bond also limits commercial diversification, and in many other jurisdictions has become less important as the movement has matured.

- ReBo

During its lifetime, ReBo completed 82 mergers involving 156 credit unions. ReBo remarked that mergers completed during its mandate have led to the expansion of underlying credit union common bonds, with related issues and questions being raised as a result. However, while ReBo acted as a catalyst in overseeing the voluntary, incentivised and time-bound restructuring process, current evidence is that restructuring is continuing within the sector.

In its final report[11] ReBo makes a number of recommendations, one of which is in relation to the common bond. ReBo recommends that 'Going forward, common bond regulations should be reconsidered so as to ensure that they do not impede the enhancement of credit union scale or business model development. ReBo also stated that as at February 2017, the top 50 credit unions by asset size accounted for 52% of total sector assets and 51% of total sector loans.

- ## Business Model Development

Credit unions are currently developing their business models. This requirement is based on a number of identified issues, including the very low average Loan to Asset ratio of circa 27%, the considerable rise in the Cost to Income ratio, a reduction in return on assets and the necessity to find new revenue avenues to ensure sustainability and viability of the sector into the future.

Many credit unions are now looking to more long term lending as a means of ensuring a steady stream of income. SME lending has also been proposed as a new opportunity for credit unions. While these types of lending will bring their own issues, discussion of those issues are beyond the remit of this paper. A separate paper has been developed by the CUAC Report Implementation Group in relation to reviewing s35 measures.

- ## Central Bank Consultation Paper 109 (CP109)[12]

The Central Bank published a consultation paper in May 2017 in relation to credit union investments which will allow for investment in social housing through investments in Approved Housing Bodies (AHBs) subject to certain requirements and limits.

[11]Restructuring of the Credit Union Sector in Ireland 2013 – 2017. Pg 40.
[12]Consultation on Potential Changes to the Investment Framework for Credit Unions. May 2017 https://www.centralbank.ie/docs/default-source/publications/Consultation-Papers/cp109/cp109-consultation-on-potential-changes-to-the-investment-framework-for-credit-unions.pdf

8. Conclusion

The 2017 CUAC Survey provides an insight into the views of individual credit unions around various elements of the common bond. All credit unions were given an opportunity to respond to the survey. Conclusions are based on those responses received and research on the common bond in other jurisdictions.

It is clear from the survey that the majority of respondent credit unions (56%) would be in favour of some change to the current common bond arrangements. This response is consistent across both Community and Industrial credit unions. 52% of respondent credit unions consider the common bond is restricting them while 59% believe the common bond is a protectionism for their credit union. The survey results, however, were overwhelmingly against the complete removal of the common bond requirements, with 69% of respondent credit unions not in favour of this course of action.

Research has shown that common bond changes have occurred in many countries, with significant relaxation of the common bond in mature and transition movements. The appropriateness of this depends upon whether it results in economies of scale and hence lower loan rates and higher dividends or whether it clouds information flows and results in increased debts for those credit unions that have widened their common bond.[13] Common bond expansion can, in some instances, lead to greater inefficiencies and the retention of earnings solely to support growth. This demonstrates that making changes to the common bond would not be beneficial to all credit unions and any modifications would need to be carefully considered.

9. Options for consideration.

The outcome of the survey suggests that it would be timely to now consider some change to the current common bond arrangements. Based on responses from credit unions and taking account of recent developments in the sector, including developments in other jurisdictions, a number of options have emerged for consideration. These options should be considered in tandem with options identified in relation to CUAC policy papers on e-voting and the credit union interest rate.

[13] See McKillop and Wilson (2011).

Options

Based on the responses received to the CUAC survey and the view of the majority of respondents that the common bond should not be fully removed, the following options should be considered:

1. The opening up of the Common Bond to assist credit unions in developing their business models and growth potential.
2. The removal of the anomaly whereby credit unions are prohibited from introducing business to each other but can introduce business to other financial institutions.
3. Any changes to the common bond should occur within a 5 year time period.
4. The rules regarding the common bond should be made clearer with better communication as to the meaning/nature of the common bond
5. Updating what the boundaries of the common bond are as in most cases these arrangements have been in place for a significant period of time.

Finally, this paper should be submitted to the CUAC Report Implementation Group for further consideration/research.

10. References

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APPENDIX I

Section 6 Credit Union Act 1997

Conditions for registration as a credit union.

6.—(1) A society may be registered under this Act as a credit union if the Registrar is satisfied that each of the following conditions is fulfilled—

(*a*) the society is formed for the objects specified in *paragraphs (a)* to *(c)* of *subsection (2)* and for no other purposes beyond those specified in *paragraphs (d)* to *(g)* of that subsection;

(*b*) admission to membership of the society is restricted to persons each of whom has, in relation to all the other members, at least one of the common bonds specified in *subsection (3)*;

(*c*) it has at least 15 members who are of full age;

(*d*) its rules comply with *section 13*;

(*e*) the place which under those rules is, or is to be, the society's registered office is in the State;

(*f*) if registered, it will participate in a savings protection scheme approved under *section 46 (1)*; and

(*g*) it has in force (or will have in force if registered) such a policy of insurance as is required by *section 47*.

(2) The objects referred to in *subsection (1)(a)* are—

(*a*) the promotion of thrift among its members by the accumulation of their savings;

(*b*) the creation of sources of credit for the mutual benefit of its members at a fair and reasonable rate of interest;

(*c*) the use and control of members' savings for their mutual benefit;

(*d*) the training and education of its members in the wise use of money;

(*e*) the education of its members in their economic, social and cultural well-being as members of the community;

(*f*) the improvement of the well-being and spirit of the members' community; and

(*g*) subject to *section 48*, the provision to its members of such additional services as are for their mutual benefit.

(3) The common bonds referred to in *subsection (1)(b)* are—

(*a*) following a particular occupation;

(*b*) residing or being employed in a particular locality;

(*c*) being employed by a particular employer or having retired from employment with a particular employer;

(*d*) being a member of a *bona fide* organisation or being otherwise associated with other members of the society for a purpose other than that of forming a society to be registered as a credit union;

(*e*) any other common bond approved by the Registrar.

(4) In ascertaining whether a common bond exists between the members of a society, the Registrar—

(*a*) shall have regard to the qualifications which are stated in the rules to be required for admission to membership of the society, and

(*b*) may, if he considers it proper in the circumstances of the case, treat the fact that admission to membership is restricted as mentioned in *subsection (1)(b)* as sufficient evidence of the existence of a common bond.

(5) For the purposes of this Act, if the rules of a credit union so provide, a person shall be treated as having the qualification required for admission to membership stated in those rules if he is a member of the same household as, and is a member of the family of, another person who is a member of the credit union and who has a direct common bond with those other members.