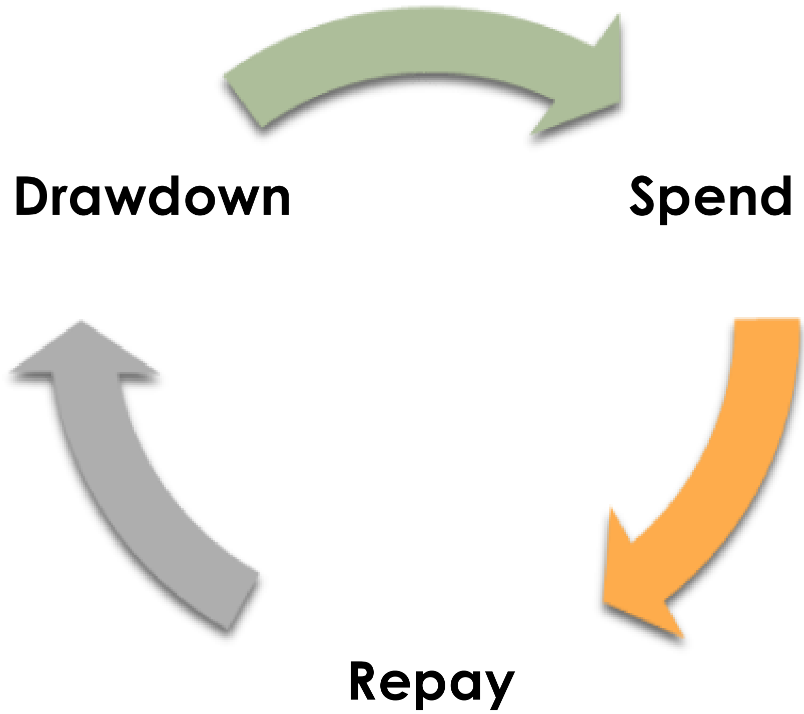
Revolving Credit product for Credit Unions

Developed through a collaboration of

CEO Forum & Solution Centre

December 2020


Drawdown
Spend
Repay

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Acknowledgements

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Tom Allen, Mullingar Credit Union ` *Kevin Johnson, CUDA*
Barry O'Flynn, Sligo Credit Union

Introduction

"The primary commercial rationale for the introduction of a Revolving Credit Loan will be to alleviate the administrative burden of top-up lending and thereby achieve cost efficiencies."

The CEO Forum Workstream and the Solution Centre cooperated to design and specify a solution that would address the inefficient practice of conducting repeat full credit assessment for those borrowers who are 'frequent' borrowers. The prevailing process is inefficient for the borrower as, each time they apply, they must provide all necessary documentation as if they were a new borrower to the credit union.

On a practical consumer level, current practice proves irritating and cumbersome for the member, while emotively it presents an image of their credit union not demonstrating that they want to get to know them and carefully advise them.

From a commercial perspective, existing practice brings high administrative cost as staff time is consumed gathering and reviewing documentation without adding value. Equally important is the emotive perspective of seeking a mechanism of building a sustainable position, based on unique level of trust that exists, and how this should be a competitive advantage for the credit union. In other words, we are seeking to enhance relevance and dispel any myth of being unable to innovate.

To build sustainable competitiveness credit unions must find their niche. Whether it is a community credit union operating with a branch and digital network, or an industrial credit union connected via digital channels, the trust members place in their credit union is unique and best suited to differentiation on a relationship basis. The working group believe for credit unions to play an active role in member decision making, this will require not only specialist staff but proper use of knowledge – human and digital together – to generate insights on personalised member needs. This competitive strategy is set out in figure 1.

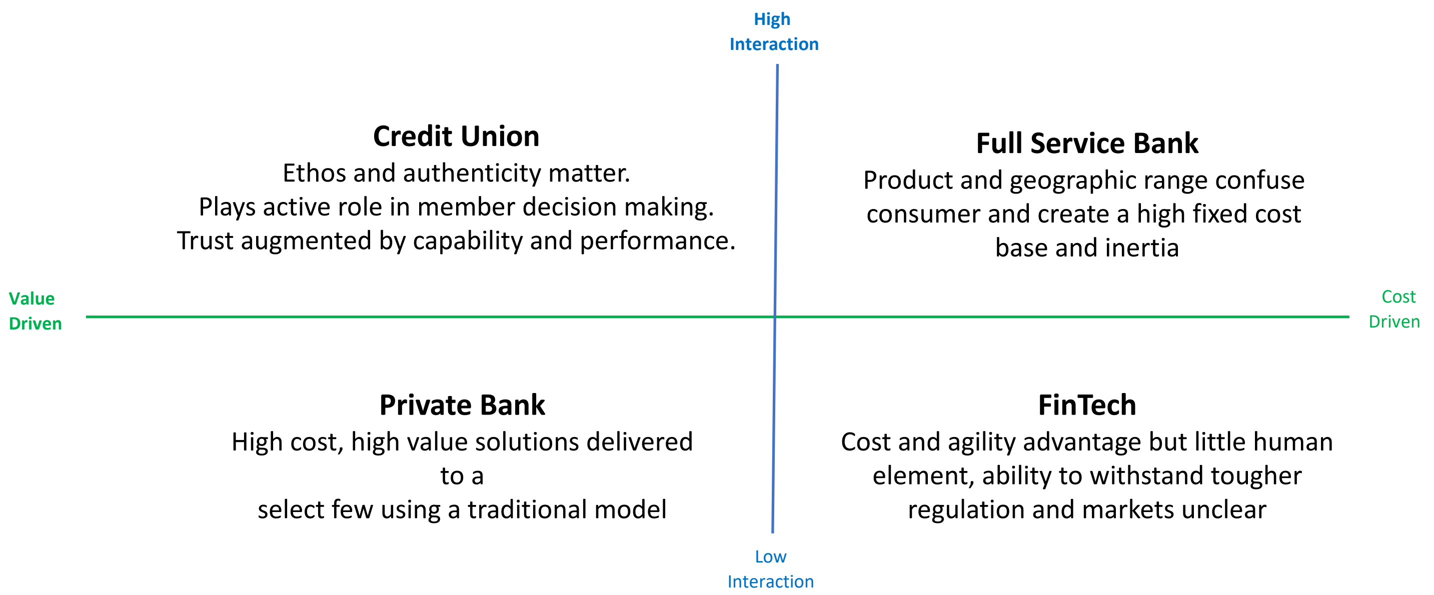

Figure 1: Competitiive Strategies and most suitable for credit unions

Avoiding the Banking and FinTech trap of automation in place of human engagement is critical. Digital can improve generation of surpluses significantly but should enable better relationships rather than displace them. The Revolving Credit Product is an example of a deliverable from such a strategy.

Another essential part of the initiative is to ensure it is a prudent approach to the provision of credit to frequent borrowers and compliant with the existing regulatory framework.

Section 1 provides a high-level business case and an insight to the large volumes of relatively small credit applications that this solution will help reduce. Section 2 highlights the success that such a collaboration can bring to credit unions and their members, while Section 3 provides an overview of the product scope and objectives. In Section 4 we consider the target market and product feature comparisons. Section 5 brings the readers through the key financial considerations and the various risks associated with such an initiative and appropriate mitigants. The final section discusses how this Revolving Credit Loan should be brought to market and some Next Steps and Reflections.

There are also three appendices, the first details the functional specifications while the second provides details of the operational requirements. The third appendix provides new loans analysis by size as provided by ILCU March 2019 PEARLS Report.

1. Business Case & Loan Volumes

Irish Credit Union lending is primarily centered on advancing personal credit to members. Standard practice has evolved that members roll forward credit by topping up their loan rather than clearing and starting a new one. Each top up is considered a new application involving a review, gathering of supporting documentation that on many occasions does not add new value to the existing information already in place. This has become expensive to administer, procedurally slow and inefficient from both a member and Credit Union points of view.

Category of Loan	Amount €	Number	% of Total	% of Value
New Loans Less than €500	13,267,421	34,070	**14%**	
New Loans €501 to €2,000	125,054,755	97,441	**41%**	
New Loans €2,001 to €5,000	198,832,900	54,806	**23%**	**78%**
New Loans €5,001 to €10,000	240,604,808	30,564	13%	
New Loans €10,001 to €15,000	152,121,962	11,594	5%	
New Loans €15,001 to €25,000	155,899,761	7,768	3%	
New Loans €25,001 to €50,000	120,901,633	3,414	1%	
New Loans €50,001 to €100,000	41,164,084	605		
New Loans > €100,000	7,776,275	60		
Average new loan €4,393	1,055,623,599	240,322	100.00	

Figure 2: ILCU March 2020 PEARLS Report

ILCU data for new loans issued for the first 6 months of both 2019 (Appendix 3) and 2020 (Figure 2) both show 78% of all loans issued are for amounts of less than €5,000 and for values of 32% and 33% respectively. Sligo Credit Union's data for the comparable period (Figure 3) in 2020 shows 84% of numbers and 43% of value issued below €5,000.

Category of Loan	Amount €	Number	% of Total	% of Value
New Loans Less than €500	221,000	603	**21.25**	**2.49**
New Loans €501 to €2,000	1,512,541	1,215	**42.81**	**17.04**
New Loans €2,001 to €5,000	2,099,896	578	**20.37**	**23.66**
New Loans €5,001 to €10,000	2,073,801	267	9.41	23.37
New Loans €10,001 to €15,000	1,385,248	107	3.77	15.61
New Loans €15,001 to €25,000	1,081,234	54	1.90	12.18
New Loans €25,001 to €75,000	500,744	14	0.49	5.64
	8,874,464	2,838	100.00	100.00

Figure 3: Sligo CU, Oct. to March 2020, Loans Issued by Size

Credit Unions are clearly spending a disproportionate amount of time processing small value loans which anecdotal evidence suggests are dominated by repeat borrowers.

Many credit unions have already streamlined their loan application, underwriting and disbursement processes through better use of technology. This has accelerated the reengineering and digitisation of processes since the onset of Covid-19 with a variety of enabling apps such as DocuSign and ID-Pal being adopted to support on-line handling of loans by credit unions. The consumer response has been positive as borrowing members are using the facilities provided by credit unions, further boosting confidence to continue the drive for a greater member experience. However, while many Credit Unions have made these improvements, there is still disparity relative to competitor offerings in terms of delivery time and convenience. Our existing borrowing members have a loyalty factor to us largely through our reputation and service. We cannot take for granted that the next generation of Credit Union borrowers will have the patience to wait for our systems to catch up on competitor offerings.

Credit Unions in Ireland do not presently have a Revolving Credit product offering available to their members. One of the banking system providers, Progress, have a Revolving Credit product on their system which has been modestly used in the UK, while the other key provider, Wellington, have a similar feature on their system but, similarly, it is not used in Ireland.

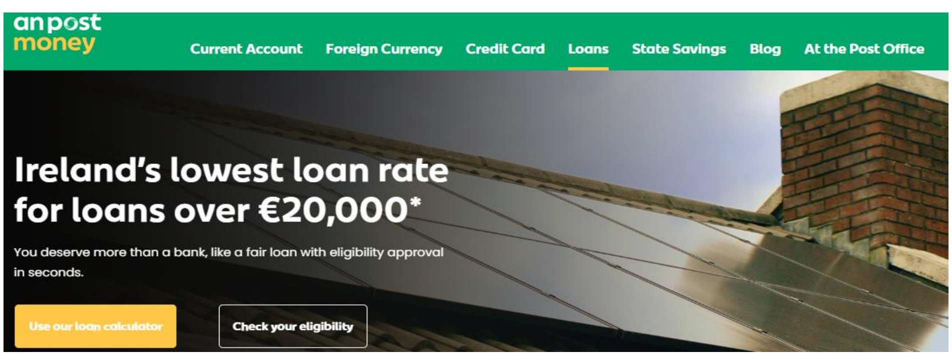

Figure 4: Personal loan ad from An Post emphasising rate and decision time

Credit Cards and Overdrafts have been the primary source of Revolving Credit for personal consumers in Ireland. Revolving Credit is part of the solution for Credit Unions who wish to offer a more complete range of flexible and segmented loan products. One compelling argument for the product was proffered by the CFCFE[1] "It has long been conventional wisdom among personal finance providers that what people hate most about dealing with them is having to bare their souls to strangers to ask permission to get money, and then suffering through the anxiety of waiting for a decision. Consumers prefer revolving credit because they only need to take that unpleasant step once." While we support the sentiment of that reasoning, we do believe that this will be time-bound and include certain caveats [these are included later in this paper].

Current Inefficiencies of Top Up Credit in Irish Credit Unions

The financial challenges of increased costs, tighter loan margins and reduced investment returns together with increased competition from traditional and non-traditional banks facing Irish Credit Unions have been compounded by the economic effect of Covid-19. To achieve the income levels required to generate surpluses to fund Investment in Technology, Regulatory Reserves etc., it is essential that Credit Unions seek ways of reducing the administrative costs associated with large volume and low-value loans. When looked at on an activity-based costing perspective these loans have a very low return on investment, a more efficient process would enhance turnaround times and generally improve the competitiveness of the offer.

Enhanced service to members

We must be able to provide members with the comfort of an approved credit which they can use when and as they require it. This product is extremely attractive to our stronger repeat borrowers and competes with quick turnaround times from competitors. The value that

[1] The Revolving Credit Opportunities for Credit Unions, CFCFE, Jones, Money & Swoboda, June 2018

standby approved credit will give to good members should not be underestimated when it comes to their choice of using a Credit Card or a competitor financial institution.

Figure 5: Personal loan ad from AIB emphasising decision time

2. Importance of Collaboration in Product Development

The business case, and in particular the financial context as set out in Section 5, demonstrates the compelling need for such a product solution.

When it was determined that the Solution Centre and a workstream of the CEO Forum were working on this initiative they readily agreed that, through collaboration and goodwill, they could drive out a more constructive result. By combining their respective work to that time, a working document was updated. This was then shared through a presentation and discussion with representatives of ILCU. The latter provided data as set out in Figure 2 and Appendix 3.

The collaboration was determined to produce a standardised product design that meets regulatory requirements, and would present a uniform specification to banking system providers.

The Revolving Credit Loan Product Design Document was discussed with the Registry of Credit Unions and, on a no objections basis, this was the foundation for a more detailed specification document.

The standardised functional specifications and technical requirements (Appendix 1) for the product were then presented at a meeting with the banking system providers. The product is based on the recently updated Top-Up Loan Credit Agreement documentation.

A small number of Credit Unions across the two primary banking systems were identified to conduct testing to ensure compliance with product, regulatory, risk and control standards. Such testing requires experienced lenders appropriately trained to ensure their understanding of the product and test scripts.

3. Scope and Business Objectives

The Scope and Deliverables of the product design work included:

1. Business Case
2. Product Features
3. Functional Requirements
4. Technical Requirements
5. Product Risks and Mitigants
6. Include Standardised Process
7. Include Draft Credit Policy
8. Include Draft Credit Agreement

The Business Objectives are to:

1. Provide sufficient detail to enable engagement with the Central Bank to confirm there are no regulatory barriers or impediment to the proposed product.
2. Provide sufficient detail for banking system providers to quantify cost of works and delivery time. This will enable the performance of a detailed cost-benefit analysis.

Product Design Context

The primary commercial rationale for the introduction of a Revolving Credit Loan is to alleviate the administrative burden of top-up lending and thereby achieve cost efficiencies.

However, there is also an arguable case that there is strong consumer demand for flexible loan products. This has perhaps been best demonstrated by Flexi-Fi, who have shown strong growth by providing consumers with convenient finance for retail purchases [2]. A Revolving Credit Loan correctly designed may therefore drive new business acquisition, or at a minimum

[2] See: The Opportunities in Point of Sale Credit and Offsite Member Engagement Solution Centre FinTech Series of White Papers [for a copy please email info@solutioncentre.ie]

provide a defensive product for credit unions to mitigate loss of existing business to non-traditional credit providers.

For a Revolving Credit Loan product to be attractive from a consumer perspective, it should offer a distinctive and differentiating value proposition. The design therefore incorporates:

- Convenience – ease of access to finance when needed without gathering and submitting paperwork;
- Control – flexible access but more easily managed than an overdraft or credit card;
- Value – competitive borrowing rate against comparable products with no hidden fees or charges [this also ensures that the Revolving Credit Loan product sits within standard credit union personal lending].

4. Target Market Feature Comparisons

While each credit union will determine its own business case and rationale for introducing a Revolving Credit Loan product to their portfolio, the target market for such a Loan will be existing members in good standing with the credit union, although new business acquisition is not excluded. It will be attractive to those who require:

1. More flexibility than a term loan; or
2. A more manageable alternative to overdraft or credit card facilities

Product design will assume that the end user will have an average to low level of financial literacy and, consistent with the obligations under EBA Guidelines on Product Oversight and Governance Arrangements (POG),that a new product can only be brought to market after it satisfies:

i. The interests, objectives and characteristics of the member have been considered;
ii. Potential member detriment has been ruled out; and
iii. Conflicts of interest have been minimised.

The Product design therefore prioritised:

- Features which are easily understood i.e. a facility of a) definite duration with b) flexible drawdowns up to c) a set credit limit with d) a minimum regular repayment.
- Costs which are transparent i.e. all costs of credit are reflected in the borrowing rate, no fees or charges for application, account maintenance or early redemption.
- Communications which are clear and unambiguous, differentiating the product from alternatives such as term loans, credit cards and overdrafts which may be more appropriate for some consumers based on their specific requirements.

A product features comparison was conducted (Figure 6). The outcome shows that the target market for the Revolving Credit Loan product is consumers financing multiple medium to high value lifestyle related expenses. Because a Revolving Credit Loan is a new product, this assumption should be tested after launch and product design may be revisited if the assumption proves inaccurate.

Product Feature Comparison

Feature	Product			
	Revolving Credit Loan	*Term Loan*	*Credit Card*	*Overdraft*
Term open ended	No, renewable	No	Yes	Yes
Ideally clear balance	1 – 3 years	As fixed	Monthly	Annually
Freedom of drawings	Yes	No	Yes	Yes
Flexibility	High	Low	High	High
Access to funds	By a/c transfer	By application	By card	By a/c debit
Cost of credit	Medium	Low	High	High
Variable interest rate	Yes	Unless fixed	Yes	Yes
Minimum regular repayment	Yes	Yes	Yes	No
Repayable on demand	No	No	Yes	Yes
Repayment period at minimum regular repayment	1 – 3 years, as fixed	As fixed in credit agreement	20 + years	N/A
Ideal use	Medium to high value regular or irregular lifestyle expenses	Irregular or once off medium to high value expense	Low value lifestyle related expenses	Low to medium value once off, regular or annual expenses
Ideal use example	Home decor, car repairs, family events, unexpected outgoing	Car purchase, home improvement	Online, travel, day to day	Car insurance, back to school, unexpected outgoing

Figure 6: Comparison of Revolving Credit product features with other forms of personal credit offerings

Audiences

The following are the anticipated audiences for a Revolving Credit Loan product and their specific needs:

Audience	Persona	Typical Use Case
Young Family **Values –** flexibility **Risk –** medium / low disposable income	• Working parents • Average income earners • Have young children • First time buyers/ long-term renters • Running two cars	• Finances well managed but tight, vulnerable to unexpected outgoings • Moving home costs • Car related costs • Childcare/school expenses
Young Professional **Values –** convenience **Risk –** limited credit history	• Unmarried • Tennant • High disposable income • Fearful of large credit card debt, wants more control over finances	• Lifestyle spending, electronics • Long haul travel • Decorating apartment • Building strong credit history before mortgage application
Empty Nesters **Values –** service quality **Risk –** retirement age may see income reduction	• Children grown, in college • Homeowners, good equity • Medium to high disposable income • Late career, early retirement potentially reduces to one income • Prioritise maintaining savings	• Education for children • Home improvement, renovations • Care for elderly parents or other health care related spending • Family events, child's wedding

5. Financial Contexts, Risk Analysis & Mitigants

Cost-Benefit Analysis

Pending costings from IT suppliers.

Pricing Analysis

The pricing analysis below is conducted on a conservative basis being a single drawdown of €1,000 repaid over two years with no additional drawings.

Under this model the following assumptions are used;

1. Average loan - €1,000 at 11.75% over 2-year term
2. Cost of Funds – dividend contribution of 0.25% of all committed funds.
3. Costs of Sale – 2.25% contribution from all committed funds towards fixed overheads
4. Provisioning – 3% of all funds at risk, conservative due to potential increase in NPLs
5. Assumed number of loans per year – 240
6. Budget for additional project costs - €5,000 for IT, €1,000 for staff training
7. Budget per loan of €2 for new Opex – potentially digital signature
8. Target Margin of 2% of all committed funds

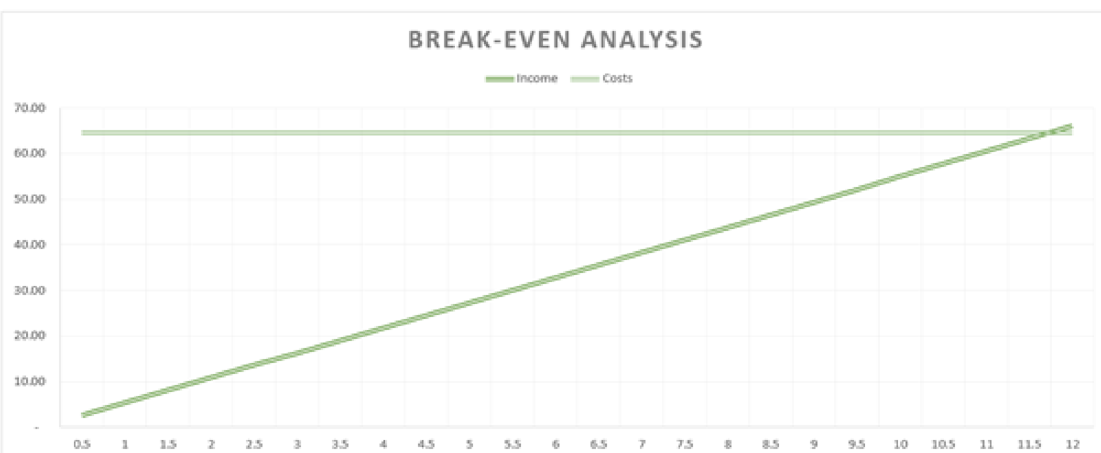

Figure 7: Sample break-even analysis for Revolving Credit Loan product

This model shows that at the assumptions set out and incorporating a target margin of 2% the break-even point for a Revolving Credit Loan product would be an annual rate of around 11.75%.

It should be noted that no allowance has been made for reductions in operating or staffing costs as these may not be realised in practice. Additional resource hours may instead be redirected to other productive purposes such as sales.

A Revolving Credit Loan would be a high volume, low margin product. Strict cost controls must be adopted and delinquency must be continually monitored and managed. There is limited budget for digitisation and this is not seen as necessary for a phase 1 implementation.

Risk Analysis

Credit Risk

a) **Credit Quality** – A Revolving Credit Loan product creates a unique credit risk insofar as a creditworthiness assessment is not conducted at each drawdown of funds, instead an initial assessment must suffice followed by periodic future assessments.

b) **Overruns** – When a credit limit is set by the initial assessment, any account activity that would cause the credit limit to overrun would cause an additional, unaccepted, credit risk.

c) **Provisioning** – A Revolving Credit Loan is a low margin product. In our projected model, allowance has been made for delinquency of 3% of funds at risk. This must be closely monitored as any upward deviation would erode already thin operating margins.

Financial Risk

Strict cost control will be necessary for the introduction of the product and there can be little tolerance for budget over runs. A thorough cost-benefit analysis cannot be completed prior to obtaining costings from IT suppliers, they in turn cannot provide detailed costings prior to receiving a Product Design Document incorporating Functional Requirements [this is complete, see Appendix 1].

Operational Risk

a) **IT Risk** – Any failure to adequately calibrate existing IT systems for the functional and technical requirements of a Revolving Credit Loan product could result in regulatory breaches or inadequate control and management of the business.

b) **Outsourcing Risk** – Outsourcing any element of technology or process underpinning the delivery of the Revolving Credit Loan product will create additional risk.

c) **Process Failure** – Transition from traditional top-up lending to a Revolving Credit Loan product would involve change to internal process. There is a risk that if a new process is not adopted correctly it will expose the credit union to loss. For example, an assessment being conducted only on an amount for initial drawdown rather than full credit limit amount due to inadequate staff training on new process would expose the credit union to additional credit risk.

d) **Internal or External Fraud** – New processes may be exploited should weaknesses exist, particularly if the internal and external audit functions are unfamiliar with the new processes. As processes for the Revolving Credit Loan product are by their nature remote and involve less interaction than with traditional top up lending, there is an increased risk of external fraud, for example a fraudulent attempt to drawdown under an assumed false identity.

e) **Legal Risk** – As a distinct new product, credit unions must be in a position to demonstrate compliance with product oversight and governance arrangements. There is a risk of regulatory fines or penalties in addition to awards of damages against the credit union for non-compliance or failure to fulfil a duty of care. There is a new burden in assuring duty of care insofar as credit affordability and appropriateness must be assessed over a term which may include extensions.

Liquidity Risk

Approved credit limits will be against committed funds and this creates an additional liquidity risk for credit unions. Failure of IT systems to correctly report on levels of committed or undrawn funds or any failure of management to adequately monitor this exposure could result in a regulatory breach of liquidity requirements.

Reputational Risk

Where there are new risks introduced for a regulated product, there is increased exposure to enforcement actions for non-compliance. Any enforcement actions against the credit union could result in negative media coverage undermining reputation.

Market Risk

There is a likelihood that the coming years will see high volatility in the interest rate market as base rates recover from historic lows. This will ultimately place upward pressure on Members' dividend expectations with any failure to satisfy these expectations exposing credit unions to a risk of flight of deposits. If market rates increase faster than anticipated, this will impact lending profitability, erosion of margins and placing particular pressure on high-volume low-margin lending anticipated under a Revolving Credit Loan product. In an extreme scenario, this may make the risk weighted margins achievable on short term lending less attractive than the deposit rates available in the investment market.

Risk Mitigants

Credit Risk Mitigations

- Specific credit policy drafted for Revolving Credit Loan;
- Credit policies to be kept under review to ensure they remain appropriate;
- All applications shall be subject to specified underwriting requirements and on such terms and conditions as specified;

- Credit reference check on all new applications as required under credit policy;
- IT systems to report on credit limits and flag overruns;
- Credit unions to utilise statistical analysis tools to analyse credit risk within portfolio and be alerted to risk exceeding stated appetite in any portion of the loan portfolio;
- Assumptions applied in pricing analysis to be reviewed on ongoing basis with necessary adjustments should NPL levels be higher than anticipated;
- Provisioning monitored on ongoing basis to comply with regulatory and FRS requirements;
- Provisioning methodology should be appropriate in context of adopted credit risk and low tolerance for erosion of margins.

Financial Risk Mitigations

Following sign-off of Product Design Document, detailed costings will be sought from IT suppliers. These will be incorporated in to cost/benefit analysis and final decision to proceed to build will be reserved until CBA is complete.

Operational Risk Mitigations

- Robust, documented testing of IT developments in sandbox prior to release;
- IT testing with defined test scripts under different scenarios which will test possible permutations and outcomes;
- Existing IT system providers will be the sole outsourced provider necessary for the implementation of a Revolving Credit Loan. Contractual service level arrangements and business continuity arrangements will be reviewed to ensure they remain appropriate;
- Compliance function involved in all aspects of product implementation to ensure compliance with all legislative and regulatory requirements;
- As part of product implementation, credit unions will appoint a project team and complete a business case that meets the requirements in the EBA Guidelines on Product Oversight and Governance Arrangements. Business case must address; regulatory compliance, cost benefit analysis, product pricing, risk appetite, impact on risk profile,

capital adequacy and profitability, expertise and availability of staff resources, internal reporting statement, roles and responsibilities statement;
- Risk function involved in all aspects of product implementation to ensure practices in line with stated risk appetite;
- Workshops held with credit union operational staff on implementation;
- Frontline staff given adequate training on new processes / changes to credit policy
- Review of product and processes by external and internal audit;
- Review of random sample loan files on ongoing basis by external and internal audit.

Liquidity Risk Mitigations

- Ability to report on committed but undrawn funds incorporated into IT systems;
- Active monitoring of liquidity in accordance with Liquidity Policy to ensure compliance with regulatory requirements;
- Where appropriate, limits may be set on maximum exposure to committed but undrawn funds.

Reputational Risk Mitigations

Credit Unions to adopt prudent approach to Product implementation.

Market Risk Mitigations

- Pricing analysis incorporates expected dividend 10 basis points higher than current sector average;
- Pricing analysis incorporates margin to insulate against market volatility in the short-term.

Every Credit Union intent on providing this product will have to ensure that Revolving Credit Loans are within their Board approved risk appetite.

6. Implementation & Next Step

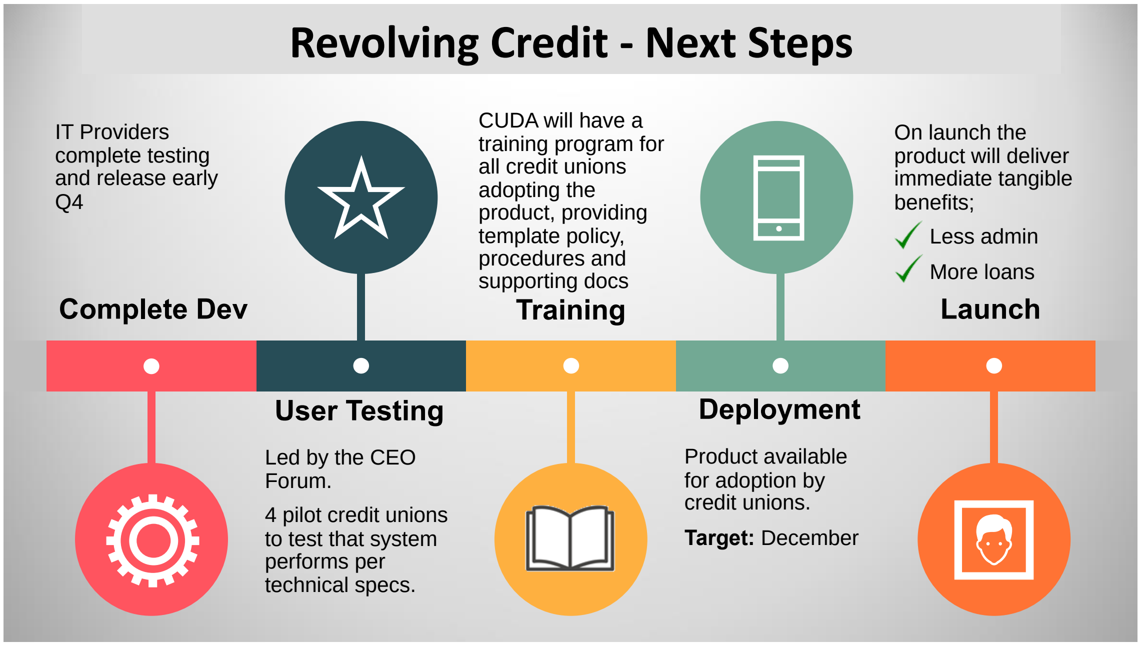

Figure 8: Summary of next steps with Revolving Credit Loan product

Phased Roll Out

The immediate next steps will be;

1. **System Testing in Pilot Credit Unions:** System testing will be conducted in reference to the Functional and Technical Requirements specified to IT suppliers to ensure systems, calculations and processes perform to specification. Testing will further ensure the specified risk mitigants are adequately embedded within the system and processes to be adopted.
2. **Training:** A comprehensive training programme will be available for credit unions prior to launch. Topics covered will include, inter alia, key product features, new risks associated with the product, unique features of the Revolving Credit Policy, unique features of the Revolving Credit Agreement and specific underwriting considerations associated with the product.

Following system testing by the CEO Forum workstream, and staff training provided by the Solution Centre, the cohort of borrowing members who frequently borrow small amounts, and have demonstrated consistent ability to repay them will be the initial market. These are often referred to as existing 'frequent' borrowers. This will facilitate credit unions offering the product the opportunity to familiarise themselves with the practices surrounding this offering. It is then anticipated that the product will be made available to the target audiences described above.

In product design, the group was also aware that there are important intangible benefits that should be considered, in particular, the benefits that a Revolving Credit Loan could bring to meeting some of the social issues which gave rise to the Personal Micro Credit Loan initiative and the efforts to tackle high cost credit providers and illegal moneylenders. This is viewed as contributing to meet the requirements of S6(2)(d) Credit Union Act 1997 – the training and education of members in the wise use of money. This has been discussed with the Chair of CUAC.

As the phased rollout occurs and experiential insights are obtained this may provide relevant data that can be transformed into numerical measures that could guide credit decisions with confidence and continue this product's evolution. That said, credit scoring[3] will also require CEOs and Directors to learn the mechanics of how it operates, have the confidence to challenge the assumptions used in modelling and constantly validate the models to ensure they remain accurate and reflect the credit union's risk appetite.

Reflections

Development of this product, via the CEO Forum workstream and Solution Centre, is a good example of positive impact of collaboration resulting in bringing a much-needed solution to market. It also evidences that the capacity and capability to design, specify and develop

[3] https://www.solutioncentre.ie/download-cs/

new and enhanced products resides within the credit union movement. Costs can be tightly controlled by selective or, in some cases, avoiding external consultancy. Furthermore, any necessary costs in this process, including legal opinion, can be shared to the benefit of credit unions. However, it is also evident that a project of this nature requires an investment in resources beyond goodwill and co-operation to bring it to market in a timelier manner.

Dialogue between the promoting credit unions and the Registry of Credit Unions at an early development stage was beneficial in the design phase from the outset and saving time in exploring avenues that would have been unfruitful.

The group also worked well to produce a very comprehensive product specification which drove the engagement with the banking system providers. This approach supports credit unions in taking ownership and responsibility for product and service strategy determination, and while factoring in the capacity of banking systems, they should not be bounded by prevailing offerings, roadmaps or timelines.

Following agreement by participating credit unions on the business need being pursued, the full value chain should be identified to deliver the project and as soon as possible communicate and discuss the relevant specific requirement with each partner. The experience of the Revolving Credit Loan product identified that prioritisation and negotiation skills must be enhanced in credit unions to assist in dealings with partners.

Finally, it might be considered that where Credit Unions operating in unison approach an IT supplier as a group (de facto CUSO) with a well thought out detailed specification, the negotiated development cost levied for the service would be expected to be lower. This provision of the business specification essentially would enable the IT supplier to focus on system functionality and facilitate greater standardisation at a higher standard.

Overall, this partnership approach worked very well and indicative of what can be achieved and delivered, and the use of this approach is recommended for future developments.

Appendix 1

Functional Specifications and Technical Requirements

General Product Features/Guiding Design Principles

Ref	Specification	Notes
F1.1	Definite duration. Although the term may be extended by drawdown activity	
F1.2	Freedom of drawdown	
F1.3	Pre-agreed credit limit, exposure shall at no time exceed limit	
F1.4	No restrictions on number of drawings once exposure remains within approved credit limit and repayments are up to date	
F1.5	Borrowing rate is variable	
F1.6	Minimum monthly repayment	
F1.7	No penalty for early redemption by borrower	
F1.8	Total cost of credit to be reflected in borrowing rate, there shall be no fees or charges	
F1.9	Applicant criteria may be set down by the credit union in the Credit Policy	

Credit Limit and Underwriting Criteria

Ref	Specification	Notes
F2.1	A credit limit shall be set at the outset of the agreement based on a creditworthiness assessment. This limit shall never be set at an amount higher than that requested by an applicant.	
F2.2	There shall be no upward modification of the credit limit unless requested by the member by a formal application and then only following a fresh creditworthiness assessment.	
F2.3	A downward modification to the credit limit shall be affected at the request of a member.	

Ref	Specification	Notes
F2.4	A creditworthiness assessment shall be within the prevailing risk appetite of the credit union.	
F2.5	At all times, the ability of the member to repay shall be the primary consideration in the underwriting process.	
F2.6	A creditworthiness assessment shall consider all information available to the credit union including information obtained from the applicant and where applicable from the ICB and/or CCR.	
F2.7	The minimum documentary requirement to be obtained from an applicant for performance of a creditworthiness assessment shall be set down in the Credit Policy.	
F2.7	A creditworthiness assessment shall consider an applicant's ability to meet their commitments under the loan agreement for the maximum potential term of the agreement.	
F2.8	A creditworthiness assessment shall be based on an applicant's actual current levels of income and expenditure as evidenced by supporting documentation together with their reasonably foreseeable future levels of income and expenditure.	
F2.9	Where the credit union considers it reasonable to factor in expected future increases to an applicant's income or future decreases to an applicant's expenditure as part of a creditworthiness assessment, this shall be on the basis of supporting evidence and at no time should the decision allow a member to take on unsustainable levels of indebtedness.	
F2.10	A creditworthiness assessment may be based on any underwriting metrics that the credit union considers prudent in establishing loan affordability but should consider the disposable income and overall indebtedness of the applicant.	
F2.11	The credit union shall stress test each application for an increase in interest rate and/or a reduction in income at such levels as may be set down in the Credit Policy.	
F2.12	Pledged shares or another form of security shall never be the sole or primary basis of a creditworthiness assessment.	

Term of Facility

Ref	Specification	Notes
F3.1	The agreement shall contain a term during which there shall be freedom of drawdowns ('Drawdown Term'). This shall commence on the date of execution of the credit agreement.	
F3.2	There shall be no drawdowns following the conclusion of the Drawdown Term. Subsequent drawdowns will necessitate a new facility with a new credit agreement with a fresh creditworthiness assessment. This will reset the Drawdown Term.	
F3.3	Repayments shall be made over a set period of time which begins to run from the date of drawdown ('Repayment Term')	
F3.4	Each drawdown during the Drawdown Term shall have the effect of resetting the Repayment Term	
F3.5	Taken together the Drawdown Term and the Repayment Term will give the term of the facility.	
F3.6	A drawdown at the conclusion of the Drawdown Term having the effect of resetting the Repayment Term shall give the maximum term. For example, where the Drawdown Term is 3 years and the Repayment Term is 3 years, a drawdown near the conclusion of the Drawdown Term would result in a maximum possible term of 6 years.	
F3.7	The maximum term allowed shall consider whether an applicant has the ability to meet their repayments for the maximum duration of the term in a sustainable manner without incurring financial difficulties or adverse consequences.	
F3.8	Life stage of the applicant shall be considered in setting the maximum term of the facility. For example, where it is known or reasonably foreseeable that an applicant is approaching retirement age, this must be considered when establishing a maximum term.	
F3.9	The maximum possible term, i.e. the Drawdown Term plus the Repayment Term shall be the term utilised by the credit union for the purposes of prudential reporting.	The regulatory provisions relating to maturity limits are subject to change and this may no longer be a requirement when clarity on new regulations are available.

Minimum Repayment and Charging of Interest

Ref	Specification	Notes
F4.1	The minimum repayment shall be a fixed amount which, taking principal and interest charges, is sufficient to repay the drawn down funds within the Repayment Term.	
F4.2	The minimum repayment shall be recalculated following each drawdown and shall consider the outstanding balance together with the amount of the new drawdown.	
F4.3	The minimum repayment amount shall be calculated as follows at each drawdown; $$A = (P + D)\frac{r(1+r)^n}{(1+r)^n - 1}$$ Where; A = minimum repayment amount P = outstanding balance from funds previously drawn down D = new drawdown amount r = interest rate per repayment period n = repayment period, typically monthly	
F4.4	Interest shall be charged only on funds drawn down.	
F4.5	Interest shall be calculated daily on a reducing balance and shall accrue at each repayment period.	
F4.6	Repayments shall first discharge interest due with the full remainder being apportioned against the outstanding principal balance.	
F4.7	Where the outstanding principal balance is of an amount less than the minimum repayment, only an amount sufficient to discharge the balance plus any accrued interest shall be collected.	

Drawdown

Ref	Specification	Notes
F5.1	Drawdown shall be in amounts of fixed increment and there shall be a fixed minimum drawdown that may be set by each credit union. For example, a minimum drawdown of €250, with the choice of drawdown amount increasing in increments.	Possible increments of €50 for amounts over €250.
F5.2	Existing security protocols for access to funds, whether in branch or online, shall apply to all drawdowns from a Revolving Credit Loan account.	

Appendix 2

Operational Requirements

Enabling Technologies and Monitoring of Accounts

Ref	Specification	Notes
O1.1	Banking system updated to include Revolving Credit Loan module satisfying requirements for; 1. Setting and enforcing credit limit 2. Calculation and accrual of interest 3. Setting of initial Repayment Term 4. Extension of Repayment Term at drawdown	
O1.2	Ability to apply for product in branch. Manual data entry to banking system.	
O1.3	Ability to apply for product by phone. Manual data entry to banking system.	Distance Regs
O1.4	Ability to apply for product online	Phase 2 requirement
O1.5	Drawdown - ability to transfer funds from Revolving Credit Loan account to any nominated account via EFT within online banking environment. An account may be nominated by creation of a new payee.	Transfer shall not cause breach of credit limit.
O1.6	Drawdown – ability to withdraw in branch. Cash/ cheque withdrawal or accept instruction for funds transfer. Manual update of banking system.	
O1.7	Drawdown – ability to make instruction by phone for funds transfer to nominated account. Manual update of banking system.	Where facilities exist to record instruction only.
O1.8	By each method of drawdown, a member must be advised of revised regular repayment and must be provided with a Supplementary Statement of account in a durable medium within 10 days. This Supplementary Statement must be produced from banking system as an addendum to the credit agreement.	*N.B. new system functionality required for phase 1 launch

Ref	Specification	Notes
O1.9	Banking system shall automatically apply new regular repayment and adjust, when appropriate, direct debit to match this amount.	
O1.10	Banking system must apply drawdowns as a stage payment, at no time breaching pre-agreed credit limit.	
O1.11	Banking system must facilitate the control and monitoring of the product. Reports shall be available for; 1. Number of loans 2. Committed funds – i.e. aggregate of approved credit limits less drawn amounts 3. Loans in arrears 4. Exceptions – loans in breach of credit limit	*N.B. O1.10(4) will be new system functionality required for phase 1 launch
O1.12	Banking system or another system must facilitate the control and monitoring of credit risk. Metrics which may be considered could include probability of default, exposure at default and loss given default.	
O1.13	Systems and technologies to bring greater automation to the credit review process are not a phase 1 requirement but should be examined as the product matures.	*Information for applicant where credit decision based on automated decision making
O1.14	Banking system must allow for termination of credit agreement; 1. At the discretion of credit union in accordance with terms and conditions 2. At the request of the applicant, accepted by credit union 3. At any time where credit limit is varied, a new credit agreement must issue	
O1.15	Where member requests drawdown notification (see O1.8 above) to nominated email, this shall be to a personal email address.	Best practice, mirrors S80 requirement, delivery personally or by post.

Procedures in the Event of Default

Ref	Specification	Notes
O2.1	Banking system must provide daily reporting on loan accounts in arrears	
O2.2	Standard Credit Control Policy and Procedures to apply on all loans in arrears	
O2.3	Where reasonable forbearance is necessary, the Repayment Term may be extended beyond the maximum. This must only be approved in accordance with such procedures as the credit union may set down, for example approval only following consideration by credit control committee.	
O2.4	Any consideration mentioned in O2.3 must include the overall indebtedness of the borrower and their full financial and personal circumstances. It must be reasonably concluded that a term extension is in the best interests of the borrower and will not exacerbate their arrears position.	
O2.5	Banking systems must prevent further drawdowns from Revolving Credit Loan accounts while in arrears	

Appendix 3

Analysis of new loans issued by size New loans issued for 6 months to Q2 March 2019							
Category of loan			**Amount**		**Number**	**% of total**	
New Loans Less Than €500			€	14,565,962	37,835	14.8%	
New Loans €501 to €2000			€	132,761,738	103,889	40.7%	
New Loans €2001 to €5000			€	209,907,943	58,003	22.7%	78.3%
New Loans €5001 to €10000			€	250,940,097	31,899	12.5%	
New Loans €10001 to €15000			€	155,848,636	11,878	4.7%	
New Loans €15001 to €25000			€	157,380,235	7,886	3.1%	
New Loans €25001 to €50000			€	110,598,797	3,120	1.2%	
New Loans €50001 to €100000			€	34,053,990	503	0.2%	
New Loans >€100000			€	9,036,221	58	0.0%	
			€	1,075,093,619	255,071		
Average new loan	***€ 4,215***						

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CEO Business Model Development Forum