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CONSULTATION PAPER FOR THE ESTABLISHMENT OF A

PROTECTION FUND

FOR DEPOSITS AND SHARES HELD IN CREDIT UNIONS

January 2014

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EXECUTIVE SUMMARY

In July 2005, Cabinet agreed that the supervision of the financial activities of all credit unions should be integrated under the regulatory ambit of the Central Bank of Trinidad and Tobago (the Bank), which is currently responsible for the supervision of insurance companies, pension funds and financial institutions. The Central Bank intends to fulfil this mandate through the establishment of a Credit Union Act (CUA).

The Central Bank, in November 2011, issued the Draft Credit Union Bill (the Bill) to the credit union sector for their comments. While the Policy Proposal Document for a Credit Union Act (PPD) had proposed that a mandatory insurance fund be set up for credit unions, the Bill was silent on the establishment of such a fund. The policy proposals for the establishment of a Protection Fund for Shares and Deposits Held in Credit Unions (Protection Fund) have been withdrawn from the PPD and will be presented separately as proposed amendments to the Central Bank Act.

A credit union which has been issued an Operating Certificate by the Bank shall become a member of the Protection Fund pursuant to the provisions outlined in this document. The mandate to operate the Protection Fund should be given to the Deposit Insurance Corporation (DIC) who will manage the Fund separately from the fund which it currently manages for banking entities.

The proposals contained herein relate to:

- Membership, establishment and administration of the Protection Fund;
- Seed and on-going funding for the Protection Fund;
- Protection of deposits and withdrawable shares;
- Coverage limits for deposit and withdrawable share accounts;
- Corporate governance and board structure of the DIC in light of its additional role as manager of the Protection Fund.

1. BACKGROUND

The Policy Proposal Document for the Credit Union Act (PPD) was approved by Cabinet in December 2009 and it contained a proposal that a protection fund for credit union members be established. However that PPD did not include the structure or the terms and conditions governing this proposed fund, neither did it state who would establish and manage this fund. The intent of this consultation paper is to inform and solicit comment on the proposals for the fund.

The establishment of a mandatory protection fund is consistent with international best practice and standards. The World Council of Credit Unions (WOCCU) advocates that such a mandatory deposit insurance system be accountable to the Ministry of Finance or other appropriate government agency[1]. There are several jurisdictions both in developed and developing economies in which credit union insurance schemes have been established. Specifically, compensation schemes have been established in Canada (the Credit Union Deposit Insurance Corporation and the Deposit Insurance Corporation Ontario) and in the United States (the National Credit Union Association Share Insurance Fund). Regionally, in Jamaica, the Jamaica Credit Union League offers voluntary deposit insurance to credit unions and in Barbados; legislators along with the Barbados Credit Union League are currently giving consideration to establishing a deposit insurance scheme for credit unions.

2. FRAMEWORK FOR DEVELOPING THE POLICY ON THE PROTECTION FUND

The positions under consideration in this consultation document were informed by meetings held with stakeholders in the credit union sector, the DIC and the voluntary insurance fund administered by the Trinidad and Tobago Credit Union Deposit Insurance Fund Co-operative Society Limited (TTCUDIF). In addition, information was gathered from the following sources, for comparative purposes and understanding of current and proposed international standards:

1. The Central Bank Act Chapter 79: 02 and amendments;

[1] Page 44 section 11.45 of the WOCCU Model Law 2005

2. The Financial Institutions Act 2008;
3. World Council of Credit Unions (WOCCU) Model Law 2005;
4. International Association of Deposit Insurers: Funding of Deposit Insurance Systems Guidance Paper 2006;
5. Basel Committee on Banking Supervision and International Association of Deposit Insurers Core Principles for Effective Deposit Insurance Systems, June 2009;
6. Annual reports on a cross section of credit unions from the years 2007 to 2010; and
7. Research conducted on other jurisdictions in the Caribbean and North America.

3. FUND ADMINISTRATOR

After careful consideration of all relevant factors, it is proposed that the DIC be responsible for administering the Protection Fund. There is existing statute governing the administration and functioning of the DIC and the DIF established for banks and non-banks; the DIC has over twenty-five years of experience and expertise in managing a similar protection fund; minimal infrastructural costs would be attached to start-up of the Protection Fund; and economies of scale should be experienced from a single-point delivery in terms of accommodation and infrastructure.

4. MEMBERSHIP IN THE FUND

Following a decision of the Minister of Finance in 2009, all credit unions shall be members of the Protection Fund. Membership will exclude secondary bodies. Membership shall be granted to all credit unions at the time of receipt of an Operating Certificate by the Central Bank. However, those credit unions that are in the process of liquidation, under receivership or being de-registered by the Commissioner at the time of passing of the legislation will not be issued an Operating Certificate and consequently will not become members of the Protection Fund.

OPERATION OF THE FUND

1) Membership in the Protection Fund is granted to all credit unions that have been issued an Operating Certificate by the Central Bank.
2) A credit union will cease to be a member of the Protection Fund if the Central Bank decides to revoke its Operating Certificate for failing to meet certain obligations set out in the Credit Union Bill, 2013.
3) The Protection Fund shall be administered by the DIC, the current body that administers the DIF established for the banking sector.
4) The assets of the Protection Fund shall be kept separate from the assets of any other fund administered by the DIC. The separation of monies shall also be in respect of any investments made on behalf of the Fund. The Protection Fund shall be established under the Central Bank Act which is the current legislation under which the DIC and the DIF have been established. Appropriate reference to the Protection Fund will also be made in the CUA.
5) It is proposed that the Protection Fund be established within one year of the CUA being passed into law.

5. PROTECTION OF DEPOSITS AND SHARES

While there is general inclusion of deposits for insurance protection in other jurisdictions, there are fewer instances of covering shares. Standard-setting bodies such as WOCCU and the International Association of Deposit Insurers (IADI) make reference only to deposits in their Guidance Papers.

In British Columbia, the Credit Union Deposit Insurance Corporation extends protection for both deposits and non-equity (withdrawable) shares as The Financial Institutions Act of British Columbia includes money invested in non-equity shares issued by the credit unions in its definition of deposits. Currently TTCUDIF offers deposit insurance coverage to the local credit union sector which covers both deposits and shares held by credit union members on a voluntary basis. Similar to the protection offered on shares by the TTCUDIF and the Province of British Columbia, and given that over 70% of savings in the domestic sector are held in shares, the Central Bank proposes that "withdrawable" shares, that is, shares not held as permanent shares, be also covered under the Protection Fund, The Fund should cover withdrawable shares in Trinidad and Tobago as they pose the greater risk of loss than deposits for credit union members in the event of a credit union's failure.

Proposals for protection of deposits and shares are described below:

(a) The Protection Fund will cover deposits and withdrawable shares held in credit unions and denominated in Trinidad and Tobago dollars.

(b) "Deposits" shall be considered to be those sums of money that are paid to a credit union, by a member whether or not evidenced by any entry in a record of the credit union receiving the sum of money but evidenced by an official receipt or statement from the credit union, on terms under which the sum of money will be repaid or transferred to another account, with or without interest or a premium, either on demand or at a time or in circumstances agreed to by or on behalf of the member and that credit union, following the definition of "deposit" as set out in the Credit Union Bill.

(c) "Withdrawable share" shall be defined as any share issued by a credit union other than a permanent share and which does not constitute any part of the institutional capital of the credit union.

6. FUNDING: SEED AND ON-GOING

Establishing the Protection Fund will require seed money to ensure that the Protection Fund becomes viable in the shortest possible time after its establishment. While initial contributions will be required to be made by credit unions upon establishment of the fund, other options for funding may have to be considered which may include contributions from the Government and/or the Central Bank.

It is also possible that there may be immediate claims made on the Protection Fund as insolvencies may be revealed once the legislation is passed. This is notwithstanding the ongoing review by the Commissioner on the assessment of insolvency in the sector and verification of continued activity for all registered credit unions. Sound funding arrangements are therefore critical to the design and operation of the deposit insurance system for the maintenance of public confidence in the credit union sector.

Deposit insurance systems can be funded in one of three ways: (i) ex-ante funding; (ii) ex-post funding; or (iii) a hybrid which has elements of both ex-post and ex-ante funding. An ex ante[2] funding system involves the advance accumulation and maintenance of a fund to cover deposit insurance claims. The fund consists of primarily premiums collected from the members of the deposit insurance system. In an ex post funding system, funds to cover claims are only collected from members when a member institution fails and there is a need to cover deposit insurance claims.

Ex-ante funding is critical to the Protection Fund being proposed to ensure that there is a liquid pool of funds to draw on to allow for prompt reimbursement to insured depositors and shareholders if the situation arises and this contributes to maintenance of confidence in the system both pre and post event. Ex-post funding may be necessary to assist in meeting claims if the level of funds obtained from premiums in relation to claims is not adequate. Ex-post funding may involve the administrator of the Protection Fund levying special premiums on credit unions and/or accessing lines of credit.

A combination of ex-ante and ex-post funding will however ensure that should a failure occur, there can be a prompt response by the DIC and the burden of funding this failure will not only be on the remaining credit unions which are strong and well-functioning but the failed credit union would have also contributed to the fund.

On an on-going basis, an adequate level of monies should be maintained in the Protection Fund so that the prompt reimbursement of credit union members can be made and the on-going operating expenses of managing the Fund can be met. In this regard, a proposal is made for the level of on-going premiums for the Fund.

[2] Definition of ex-ante and ex-post taken from the IADI's *Funding of Deposit Insurance Systems Guidance Paper-May 2009*

Proposals for funding are described below:

1. For purposes of seed funding, each credit union will be required to contribute an amount equal to 0.4% of its total eligible deposits and withdrawable shares. The seed funding contribution of the credit unions will be payable within 6 months of the establishment of the Protection Fund.
2. Credit unions will pay a premium equivalent to 0.10% of deposits and withdrawable shares per annum. The premium will gradually be increased to 0.20% at a rate to be determined by the Protection Fund administrator.
3. Annual premiums will be levied on deposits and withdrawable shares of member credit unions, payable semi-annually.
4. Additional funding, if required, may be sourced by way of special claims levied on credit unions or through Government lines of credit.

8. COVERAGE LIMITS

Coverage limits shall be established and publicized so as to inform and inspire confidence in depositors and shareholders. WOCCU also suggests that coverage levels for credit union deposit should at least be on par with coverage levels for deposits held by other depository financial institutions in a given country. As such the following is proposed:

Proposals for coverage limits are described below:

1) The coverage limit for each member of an individual credit union is $125,000 to be payable in Trinidad and Tobago currency. This $125,000 will cover up to $50,000 on withdrawable shares and $75,000 on deposits;
2) Claims will be settled on a net basis taking into account any liabilities of a member to the credit union;
3) Coverage will apply to the following accounts:
    a. to an individual account holder;
    b. to joint account holders;

c. to the beneficiary/beneficiaries of an account holder.

9. CORPORATE GOVERNANCE AND BOARD STRUCTURE

The following proposals are to ensure that the management of the Protection Fund are held to certain standards and provide transparency and certainty to all stakeholders.

Proposals for governance and board structure are described below:

1) The addition of the credit union sector under the administration of the DIC will necessitate credit union expertise being represented on the Board of the DIC in addition to the existing requirements;
2) The Protection Fund will be operated as an independent and separate fund managed by the DIC along similar principles and guidelines utilized for the DIF established for banks;
3) For the proper management and administration of the Protection Fund, the DIC, consistent with its current mandate and functions, shall have the power and general responsibility:
   a) to appoint and employ such number of managers, employees and officers and other personnel as it considers necessary or desirable for the efficient performance of its functions and upon such terms and conditions as is required;
   b) to levy authorized contributions and premium from credit unions;
   c) to recommend to the Bank the suspension of business or closure of any credit union where that credit union is in financial difficulty;
   d) to act as receiver or liquidator of an insolvent credit union;
   e) to arrange after consultation with and on the advice of the Bank for the restructuring of a failed credit union whether by merger with a financially sound credit union or otherwise;
   f) to pay off deposits and shares;
   g) to deduct from moneys from the Protection Fund due to a member, any loans due, called-in guarantees and to set-off deposits or shares pledged as collateral, subject to prior claims being paid;

h) to require from any member of the board, manager, officer, agent or employee of a credit union or from such person in an affiliated entity any information in relation to its business or the production of any document or record under his custody or control;

i) to educate credit union members on the importance of deposit insurance;

j) to determine premiums to be assessed;

k) to determine coverage amounts of deposits and shares.