

## Should the Credit Union Movement in Fiji be Externally Supervised?

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### *Abstract*

*As financial markets have become more sophisticated, the framework to regulate and supervise their operations has commensurately changed. Credit unions have now begun to receive closer attention, given their important role in facilitating economic growth by mobilizing savings for productive use. Although they comprise a small proportion of the financial sector's total assets and are presumed not to be involved in sophisticated financial instruments and therefore risks, they do serve a large number of small depositors and are exposed to a number of financial and operational risks. The credit union sector in Fiji, though functional for long, has not been subject to external supervision. This paper reviews the operational process of credit unions in Fiji and discusses whether the current status of the industry warrants external supervision.*

### **Introduction**

Credit union is a member-owned not-for-profit financial cooperative that provides savings, credit and other financial services to members. They pool members' savings, deposits and shares to finance loan portfolios at relatively lower cost and ease rather than relying on outside capital. The objective of the credit union philosophy initially was to focus on providing financial services to people who otherwise had limited or no access. Their scope of operation, however, has widened from this traditional role over the years. Group services such as insurance policies, group purchasing plans, and legal services are also provided by some more developed credit unions. These organizations are given legal status

in Fiji through registration under the Credit Union Act (1954). Though their operation is similar to the operations of commercial banks to some extent, they are unique in terms of their operation and structure. A common-bond is a prominent feature of credit unions, with members as both owners and consumers of the financial services provided.

The 2011 Statistical Report of the World Council of Credit Unions (WOCCU)<sup>1</sup> shows that the total number of credit unions worldwide grew by 19 percent to 51,013 in 2011 from 2005. Membership rose by 25 percent to around 196 million people during the same period. Total assets of the credit union sector stood at \$US894 billion in 2011. The Pacific region shares 0.3 percent of the total number of credit unions worldwide. The 2011 Statistical Report of the Oceanic Confederation of Credit Union Leagues<sup>2</sup> (OCCUL) shows a total of 171 credit unions in the Pacific region, serving approximately 231 thousand members with a combined asset of \$US341 million. These statistics provide a brief picture of the growing influence of credit unions worldwide and in the Pacific region as well.

Credit unions have shown strong resilience to economic or/and financial downturns. Ryder & Chambers (2009) examined the resilience of credit unions in the US during the Great Depression (1930) and in the UK during the Credit crunch (2007-2009). During this economic slump in the US, poverty and unemployment rose sharply and many financial institutions failed. However, the same Great Depression underpinned growth in the credit union sector - where the number of banks fell by 50 percent, the number of credit unions grew by 107 percent. Similarly, during the 2008 credit crunch<sup>3</sup> in the UK, a large number of credit unions reported growing membership and loan applications. These subdued economic conditions, therefore, turned out to be a positive factor for the credit union sector, as other financial service providers failed to provide services to consumers.

Most countries are using credit unions as important microfinance media, particularly to improve access to financial services for small scale business operators who are unable to source the same from the banking

<sup>1</sup> WOCCU is the leading global trade association and development agency for the international credit union movement representing more than 51,000 credit unions in 100 countries.

<sup>2</sup> The report includes the following countries: Fiji, Kiribati, Papua New Guinea, Solomon Islands, Timor Lester, Tonga, Tuvalu, Federated States of Micronesia, Samoa, and Vanuatu.

<sup>3</sup> The global financial market uncertainty, partly fuelled by the recent subprime mortgage crisis in the USA led to dramatic reduction in availability of credit in the UK.

sector.

The WOCCU News Release (April 2012) reported the involvement of the Caja Providenciaa Credit Union in Mexico to develop a value chain financing program for fruit growers. Value chain financing provides financial access to farmers at key points within the planting, growing and harvesting cycle to make sure they have sufficient funds to operate their businesses. Similar initiatives in other Mexican rural areas have assisted farmers to gain access to new financial and agricultural tools and earn more stable and higher income, together with sustainable crop production.

Similarly, the Ethiopian credit union movements are also benefiting from the WOCCU programs through improvement to production and incomes of their farmer-members. Branch & Evans (1999) note the role of credit unions in provision of microfinance. Farmer credit unions have the potential to improve local markets with services and market access by those who lack access to key financial services, particularly small farmers and micro entrepreneurs. Such credit unions fill the deficiency from commercial banks that are mostly concentrated in the urban areas.

The growing economic significance and the changing financial environment have prompted many countries to relook at their existing regulatory frameworks for credit unions. Globally, the level of formal legislation and regulation of credit unions varies widely. In some countries credit unions are subject to extensive legislation, however, in most countries legislations and regulations have not been adequately developed, or have not kept pace with the changing environment in which credit unions operate. Moreover, even if legislation and regulations do exist, they are often weak and ineffective. According to a 2005 WOCCU study, only 36 percent of the 104 countries surveyed had credit union specific legislation. The study also highlighted the weak supervision in this sector, with only 38 percent of all countries surveyed having appropriate legislated supervisory body; of this 16% was done by specific financial sector regulator, 13% by the central bank<sup>4</sup>, and 9% by the Ministry of Finance. The rest of the countries were inadequately or weakly supervised, as by the Registrar of Cooperatives/Credit Unions, League or the National Credit Union/Cooperative Administration.

Unlike two of our Pacific Island counterparts (Papua New Guinea &

Solomon Islands)<sup>5</sup>, where this industry is regulated by their central banks, Fiji does not have any central regulation. There, thus, is no external supervision of their financial performance and risk activities of credit unions. Compared to other Pacific Island countries, Fiji has a well developed financial market. The range of institutions operating in Fiji's financial market include banks, credit institutions, life and general insurance companies, a provident fund (FNPF), securities brokers, dealers, investment trusts, foreign exchange dealers, credit unions, cooperatives and money lenders. Of these, commercial banks, non-banking financial institutions, insurance companies and the FNPF are supervised by the Reserve Bank of Fiji (RBF).

The total size of assets in the financial system (regulated and non-regulated) in 2011 was estimated by the RBF to be approximately \$11.1 billion; of this \$10.5 billion (95%) was held by the prudentially regulated sector (with 47 percent in the banking sector, 38 percent in FNPF, and 10 percent in the insurance industry), and approximately 5 percent in credit institutions (RBF Annual Report, 2011). The credit union movements' share of total assets in the financial system is only marginal at a three year average of 0.9 percent.

The Credit Union Act provides for registration and operational guidelines for this sector. Nevertheless, even though collective assets of credit unions may be low in comparison to other financial intermediaries such as commercial banks, they do serve a large number of small depositors. Most countries have used this as the basis for bringing in prudential supervision of this industry. The unique characteristic of credit unions and the presence of a large number of geographically dispersed small credit unions do cause a challenge to any supervisory authority. But this ought not to be the basis for excluding credit unions from the supervisory framework.

The issue, therefore, is whether the credit union sector in Fiji requires external supervision, and if so, then what should be the basis for such supervision. Although data constraint<sup>6</sup> is a limiting factor, we attempt to draw conclusions from available resources.

<sup>5</sup>According to the WOCCU 2011 Statistical Report, PNG has 20 credit unions, with an asset size of \$US223 million and market penetration rate of 11.1 percent. The Solomon Islands has 15 credit unions, with an asset size of \$US0.2 million and market penetration ratio of 1.6 percent.

<sup>6</sup>Most data was sourced from the Fiji Savings Credit Union League (FSCUL) which has data mostly for its affiliated members. There is limited or no data for the non-affiliated credit unions due to poor record keeping and resource constraints.

<sup>4</sup>This includes Ethiopia, Ivory Coast, Rwanda, Senegal, Togo, Suriname, Netherlands Antilles, Latvia, Lithuania, The Netherlands, Argentina, Brazil, and Uruguay. More recently, Papua New Guinea and the Solomon Islands have also assigned supervision authority of credit unions to their respective central banks.

## Overview of the Credit Union Movement in Fiji

Credit unions have a long history in Fiji. The concept of credit union was brought to Fiji in late 1953 by Father Marion Ganey, an American Jesuit priest. The credit union was seen as an opportunity to bring out self-reliance, art of saving and thrift among the Fijian people. It facilitated the development of the virtues necessary for economic and social expansion at grassroots level. According to Arbuckle (1969) the idea was received with great enthusiasm, with the first credit union established in the country in January 1954. This was followed by the establishment of the Credit Union Ordinance in July 1954 which later became the Fiji Credit Union Act. This act regulates the credit union movement in Fiji and is enforced by the Registrar's Office under the Ministry of Justice.

The number of credit unions and members served indicate the sector's social impact. The initial years saw a significant growth in both membership and the number of unions formed, as shown in Table 1.

**Table 1: Credit Unions, 1954-2012<sup>7</sup>**

	Number of credit unions	Number of members	Market penetration ratio (%) <sup>*</sup>
<b>1954</b>	66	8,347	2.6
<b>1964</b>	288	32,407	7.2
<b>2005-06</b>	47	21,932	2.7
<b>2007-08</b>	37	19,643	2.3
<b>2009-10</b>	30	18,843	2.2
<b>2011</b>	30	18,843	2.2
<b>2012</b>	28	16,192	1.8
<b>% change</b>			
<b>1954-64</b>	336%	288%	
<b>1964-2012</b>	-90.3%	-50.0%	-75.0%

(Source: Arbuckle (1969); Fiji Islands Bureau of Statistics, various years; (Source: FSCUL; WOCCU 2011 Statistical Report; FTUCTCL & SWCU Annual Reports).

<sup>7</sup> The data for 2012 is provisional. The FSCUL is in the process of collecting more details on credit unions in the country, particularly those that are not members of the FSCUL. 2005-2011 data includes both members and non-members of the FSCUL, and amended by authors to include the Fiji Teachers Union Co-operative Thrift and Credit Limited (FTU-CTCL). FTU-CTCL operates as a financial co-operative and is regulated by the Co-operatives Act; however, its core function remains that of a credit union. 2012 data is as at 30 June, of which 26 credit unions are FSCUL members, plus Service Worker Credit Union (SWCU - non-member) and FTU-CTCL.

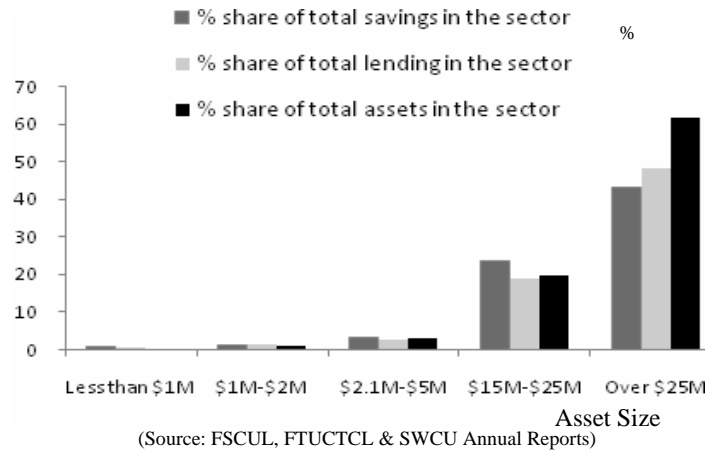
The number of credit unions created rose by a significant 336 percent over the initial ten year period while the number of members saw a dramatic growth of 288 percent. The market penetration ratio rose from around 3 percent in 1954 to about 7 percent in 1964, implying its growing social impact. The growing interest in this movement led to the establishment of the Fiji Savings and Credit Union League (FSCUL) in 1957, which is the representative body of credit unions in Fiji operational through membership funding. It provides assistance (technical, education, training) to the credit union sector. Membership to this organization is voluntary; credit unions are not legally obliged to provide information or join the FSCUL, which further limits the operational capacity of this organization.

More recent data, however, shows an altogether different picture of this industry compared to the initial explosive growth that it experienced. As Table 1 shows, the number of credit unions shrunk dramatically from 288 in 1964 to only 28 by June 2012. Along the same period, membership also narrowed by approximately 50 percent. The market penetration ratio has fallen from around 7 percent in the 1960's and remained at around 2 percent from 2005 to mid-2012.

Interesting however is the fact that in the 1960's a total of 288 credit unions supported around 32,407 members, an average of 112 members per union. The 2012 data shows that only 28 credit unions are now serving a total of 16,192 members, an average of 578 members per union. While in the 1960's, a large number of relatively smaller sized (in terms of membership) credit unions were operating, now the membership average has been pushed up by a handful of relatively large credit unions. A majority of the older unions were village-based and are now inactive. The characteristic now depicts an industry which has a few dominant credit unions together with relatively smaller membership based unions. A minimum of 15 members are required to form a credit union. Appendix 1 shows the membership status' of the credit unions.

The financial strengths of the unions also vary considerably. Figure 1 shows the diversity in terms of financial strengths. The largest 20% of the credit unions account for around 80 percent of total membership, while the smallest 20% account for only 1.6 percent. The relatively larger credit unions dominate the sector's lending and savings activities.

Table 2 shows average ratios of some key indicators that are most important requirements for the effective management of risk taking by credit unions.

**Fig 1: Financial data of Unions**

(Source: FSCUL, FTUCTCL &amp; SWCU Annual Reports)

**Table 2: Summary of selected credit union ratios by asset size\***

Average ratios	Asset size				
	<\$1m	\$1m-\$2m	\$2.1m-\$5m	\$5m-\$25m	>\$25m
<b>CAPITAL ADEQUACY</b>					
Capital/assets ratio	95.3%	88.6%	89.7%	85.6%	53.9%
<b>QUALITY OF ASSETS</b>					
Net profit/assets	3.6%	12.9%	5.2%	0.3%	0.4%
Operating expense/assets	9.0%	3.6%	8.4%	0.8%	2.0%
Fixed assets/assets	0.2%	0.3%	21.2%	25.5%	24.5%
Non-performing assets/assets	6.4%	8.9%	29.5%	8.7%	24.9%
Earning assets/assets	93.6%	91.1%	70.5%	91.3%	55.3%
<b>LIQUIDITY</b>					
Current liquidity ratio	6.4	0.8	19.7	0.5	6.4
Savings to loans turnover	102.9%	70.3%	84.3%	104.7%	76.4%
<b>EFFICIENCY</b>					
Loans/Assets	86.9%	90.1%	54.3%	63.7%	51.8%
Borrowed funds/Assets	2.9%	0.1%	3.1%	10.9%	39.5%
Income gaining assets/cost bearing liabilities	9.1%	10.7%	5.3%	12.4%	1.3%
Members shares/total assets	89.2%	63.4%	64.5%	66.5%	39.5%

\* The ratios are calculated from the financial reports of CUs. As such these are not fully reflective of the performance of the whole sector. See Appendix 3 for the formula used in calculating these ratios. (Source: FSCUL, SWCU & FTU-CTCL Annual Reports)

Like all businesses, credit unions have distinct financial characteristics. These also reflect the disparities in their financial performance. Given the caution on the ratios contained in Table 3 only an overview of the disparities in scope of operation and financial performance within the sector can be gleaned. The diversity has important implications on the development of a regulatory framework for credit unions in Fiji in that a 'one-size-fits-all' approach may not be appropriate.

Though credit unions' characteristics differ from commercial banks, a comparison of their respective market share and growth in key activities provides useful insights to the degree to which credit unions are serving their members. Despite their relatively smaller size in activity (savings and lending), credit unions compete with commercial banks and other credit institutions in the market for household savings and consumer loans. As shown in Table 3, over the 3 year period they absorbed an average of around 2 percent of total private sector deposits and provided 6 percent of total private sector loans. Amidst this relatively smaller market share, their growth in activity is remarkable, with savings growing by around 3 percent, compared to close to 8 percent private savings growth by commercial banks. More interestingly, their lending to households shows a stronger growth of 6 percent, which is more than commercial banks (2 percent) and other institutions (5 percent).

**Table 3: Household Savings and Lending: 3-year (2009-11) Average**

	Credit Unions	Commercial Banks	Others
<b>Household savings (F\$M)</b>	58.1	2,422.5	-
<i>% Growth</i>	2.8	8.4	-
<i>% market share</i>	2.3	97.7	-
<b>Household lending (F\$M)</b>	65.2	846.8	68.6
<i>% Growth</i>	5.9	1.7	4.8
<i>% market share</i>	6.0	78.4	15.6
<b>Assets (F\$M)</b>	92.8	4,640.0	
<i>% of total financial system</i>	0.9	43.2	
<i>% of total financial system excl FNPF</i>	1.4	68.1	
<i>% of GDP</i>	1.8	82.0	
<i>% Growth</i>	11.5	7.4	

\* Others include those that provide consumer loans - (Home Finance Co. Ltd, Credit Corporation Fiji Ltd, Merchant Finance & Investment Co. Ltd and Fiji Development Bank (FDB).

(Source: RBF Quarterly Review (March 2011), FSCUL, Annual Reports of Credit Unions, RBF Annual Report 2011)

Compared to commercial banks, credit unions' asset size is significantly smaller, representing a small fraction of total financial system assets (0.9%) and the economy (1.8%). Therefore, there is no immediate threat to stability of Fiji's financial system. Remarkable though is their comparatively higher average growth in assets of close to 12 percent, compared to commercial banks.

**Credit Union Regulation**

Credit unions in Fiji are currently regulated by the provisions of the Credit Unions Act (1954) and the associated by-laws. There are also provisions for certain policies to be internally formed, the competence of which depends on efficiency of internal governance. Generally, according to Branch et al (2008), one of the most significant factors that limit the development of credit unions is a restrictive legislative framework that has not kept pace with development of credit unions. For Fiji, there have been limited revisions to the Credit Union Act (1954); there also has been weak or no supervision of this sector by the ministry that is responsible for the Credit Unions Act. The legislation is too general with more focus on operational regulations and limited focus on the financial health of the credit unions.

We provide in Table 4 a review of the current provisions of the Act, and list the requirements for the creation of a sound and conducive environment for this sector.

**Table 4: Review of the Credit Union Act and Proposed Improvements**

Provision under the Credit Union Act	Proposals: Legislation to provide mechanisms for:
<b>Accounting and audit regulations</b>	
<ul style="list-style-type: none"> <li>• payments evidenced by receipts</li> <li>• subject to limitation and control by board of directors the treasurer has custody of all funds, securities, valuable papers, deposit cash, sign cheques, maintain full and complete record of all assets and liabilities</li> <li>• prepare monthly financial statement within 15 days after close of each calendar month</li> <li>• supervisory committee to inspect and audit books, cash, accounts and loans.</li> <li>• supervisory committee to make or provide an annual audit and provide written report to mem-</li> </ul>	<ul style="list-style-type: none"> <li>• standardized accounting procedures and formats</li> <li>• performance targets</li> <li>• required accounts</li> <li>• consistent dates for fiscal year</li> <li>• standardized and compulsory audit standards</li> </ul>

<ul style="list-style-type: none"> <li>• members at annual meeting</li> <li>• documents &amp; book of accounts maintained in such form as the Registrar may prescribe</li> </ul>	
<b>Prudential regulation</b>	
<ul style="list-style-type: none"> <li>• invest in any stock, debenture stock, funds or securities</li> <li>• lending to members only for productive or provident purpose (interest rate capped at 1% per month)</li> <li>• deposit money with any bank in Fiji</li> <li>• borrow money as long as total indebtedness in respect of borrowing doesn't exceed 50 percent of the sum of deposits and paid up value of issued capital. Not less than 75 percent of members consent needed if borrowings increases total indebtedness to more than 25 percent of deposits plus paid up value of issued capital.</li> <li>• secure loans and property against loss</li> <li>• may own or lease land</li> <li>• reserve fund (transfer into reserve fund not less than 20 percent of net earnings for the year until such fund is equal to 10% of deposits on shares plus issued capital). This fund to be held as a reserve against bad loans or losses. Not to be used for any other purpose except on liquidation.</li> <li>• special reserve may be established from time to time by Board of Directors</li> <li>• declare dividend after provision for reserve fund. Limited at 6% per annum.</li> <li>• debt can be recovered through legal action</li> </ul>	<ul style="list-style-type: none"> <li>• establish financial standards to safeguard member deposits</li> <li>• standardized loan policy</li> <li>• explicit capital adequacy requirement</li> <li>• limit on non-earning assets</li> <li>• loan loss provisions</li> <li>• liquidity requirements: definitions, the minimum amount of liquidity required as a percentage of withdrawable deposits, the method for evaluating liquidity, and identified liquidity sources.</li> <li>• loan delinquency controls</li> <li>• external borrowing sources, policy, limits, financial conditions required, maximum amount, security</li> <li>• allowable investments (level of risk, limits) and approval procedure</li> </ul>
<b>Administrative regulations</b>	
<ul style="list-style-type: none"> <li>• registration &amp; powers of credit union</li> <li>• membership (bond, application, other conditions, withdrawal, expulsion)</li> <li>• banking (deposit and cheques)</li> <li>• amalgamation (consent of registrar required, voluntary amalgamation to be passed by majority of not less than two-thirds of all members, procedure, transfer of liabilities, disputes on assets &amp; liabilities during merger to be referred to registrar)</li> <li>• dissolution procedure and provisions</li> </ul>	<ul style="list-style-type: none"> <li>• more explicit guidelines on mergers (criteria such as size, financial condition &amp; growth potential to evaluate need for merger)</li> <li>• technical assistance for merger</li> <li>• process of voluntary liquidation</li> <li>• involuntary liquidation (criteria to determine, conditions, procedure (informing members, treatment of assets &amp; liabilities, disposing assets)</li> </ul>

<b>Operational regulations</b>	
<ul style="list-style-type: none"> <li>• procedure for dividend payment</li> <li>• transfer &amp; withdrawal of shares</li> <li>• nomination, election, voting and duties of directors and committee (credit committee, supervisory, loan officers)</li> <li>• meeting and procedures</li> </ul>	<ul style="list-style-type: none"> <li>• record preservation</li> <li>• disaster preparedness</li> <li>• security requirements</li> </ul>
<b>Enforcement &amp; supervisory regulations</b>	
<ul style="list-style-type: none"> <li>• may be examined by or under direction of Registrar at any time or when fraud or irregularity is suspected.</li> <li>• list of offences</li> <li>• general penalty (if no specified penalty a fine not exceeding \$50, if continuing offence a fine not exceeding \$2 for each day of offence)</li> </ul>	<ul style="list-style-type: none"> <li>• procedure for reporting fraud/irregularity</li> <li>• consistent examination of credit union operation and financial performance</li> <li>• identify the supervisory authority, define its administrative actions, powers &amp; actions (resolve problems, corrective actions)</li> <li>• disciplinary steps</li> <li>• detailed penalty for different offences</li> </ul>
<b>Consumer protection regulations</b>	
<ul style="list-style-type: none"> <li>• general guidelines on buying shares, transfer and withdrawal of shares, repayment of loans</li> <li>• interest rate capped at 1% per month</li> <li>• financial reports to all members in annual meetings</li> </ul>	<ul style="list-style-type: none"> <li>• identify requirements for accepting deposits, making loans and collecting loans</li> <li>• transparency on all such procedures (interest rate calculation, security, procedure if default)</li> </ul>

(Source: Credit Union Act 1954, and associated by-laws; WOCCU Technical Guide on Credit Union Regulation & Supervision, 2008).

### Is there a need for external supervision?

Literature brings to the fore a number of different models of credit union supervision (Andrew, 2009; Gallardo, 2002; Johnson, 2011 and Raina, et. al., 2008). There, however, seems to be a consensus that the ministry or agency that regulates financial institutions should supervise credit unions through a specialized unit trained in their nature, risks and methodologies. The WOCCU also strongly supports this approach, stating that it brings in greater public confidence which results in higher membership and savings growth.

The evolution of supervisory approaches for credit unions is largely dependent on the phase of development of the credit union movement. In the early years of development, credit union regulations tend to focus on basic functions such as licensing and registration. The Credit Union Ordinance of Fiji was adopted in 1954 to serve this purpose. As these movements mature, standards for prudential behaviour tend to emerge, for example, liquidity, capital, and other risk management requirements. The current Credit Union Act has not adequately kept pace with growing maturity of few credit unions. In Fiji the progress towards maturity in this sector is mixed, with a few unions growing far from the traditional role of savings and lending, while many are still operating as non-profit community based organizations.

Following the establishment of standards for prudential behaviour, an appropriate authority is either created or an existing authority is tasked with supervisory roles in areas such as assessing risk, financial reporting, regulatory reporting, and on-site field examinations. External supervision is currently non-existent in Fiji. However, affiliated members of the FSCUL receive development assistance and training from the OCCUL, WOCCU and the Credit Union Foundation of Australia.

As a whole, the credit union industry does not pose any direct threat to the soundness of Fiji's financial system, given its relatively small asset base. The industry's market share in terms of total assets in the financial sector is only 0.9 percent. One could argue that this rules out the need for prudential supervision by the central bank since it does not threaten its key objectives. However, more recently, the RBF has widened its role in the Fijian economy and has embarked on goals such as microfinance and financial inclusion. The credit union movement could be developed into an effective microfinance vehicle, as evidenced in other developing countries. Country experiences show an improvement in economic conditions through microenterprise development with the availability of cheaper and simpler access to finance. The role of credit unions in increasing financial inclusion can also be potentially extensive.

Under Fiji's legislation, the principle purpose of credit union lending is for provident or productive purpose. Selected credit unions lend for business purposes guided by internally determined loan policies. With effective regulation the scope of lending for business purposes could be further developed.

The market penetration ratio which reflects its outreach in the country in terms of total population, is estimated at around 2 percent. Though small and declining in terms of its social impact, the credit union industry is entrusted with the valuable savings of a large number of small deposi-

tors. According to the FSCUL, the non-affiliated credit unions do not have sufficient deposit protection should the respective credit union collapse financially. The FSCUL runs an in-house insurance scheme for affiliated credit unions whereby members' shares and loans are insured under it. One of the reasons for the decline in the number of credit unions was reported to be financial failure emanating from weak internal governance and risk management. In light of consumer protection, effective regulation is critical. According to the Consumer Council of Fiji, a total of 9 consumer complains regarding credit unions were received over the period 2009 to mid 2012. Despite this small number of complains, effective regulation is needed since a large number of small depositors are involved in this industry. This would also boost consumer confidence in this sector and further its market penetration in the country.

The industry is dominated by closed-bond membership, though the degree of bonding varies. A few credit unions are tightly bonded through common employer or occupation, such as teachers, police force, and nurses. On the other hand, selected credit unions have members from a wide array of occupations. One example is the Service Workers Credit Union. Totally open membership is either nonexistent or limited. A few credit unions are exploring the possibilities of expanding membership to members' immediate families. This closed-bond membership weakens the need for any external supervision. But the same could be an opportunity to create an environment conducive for open membership with two-fold impacts; firstly, widening credit unions' scope of operation, and secondly, broadening outreach to the wider population.

Dulare (2011) shows the relatively high cost and complexity faced by Fiji consumers in accessing financial services from the banking sector in Fiji. He argues that access to the banking sector services for middle to lower income group is severely constrained and costly. Complex and expensive access to financial services is a major hindrance in many ways. It limits people's ability to improve their living standards in terms of purchasing consumer durables, housing, education, and or venturing into microenterprise development for sustainable living. An effective regulatory framework that addresses the current deficiencies in the credit union industry could support the industry to evolve into effective and relatively cheaper microfinance medium. The banking sector in Fiji is highly uncompetitive, leaving consumers with little substitutability in terms of financial services (Dulare, 2011). A vibrant and resilient credit union system has the potential to offer this substitution.

In Fiji, there are a few dominant credit unions with market share of close to 80 percent of the total industry. A few of these enjoy financially

strong performance with substantial growth in terms of assets, loans and deposits. In line with this impressive growth, these dominant and more successful credit unions have widened from their traditional role and are involved in more risky investments such as in real estate and shares, alongside external borrowing to finance their wider scope of operation. This necessitates the need for effective regulation to foster financial discipline due to absence of market discipline factors.

### **Adopting a Regulatory Approach**

Several models of credit union supervision have emerged worldwide, each with its strengths and weaknesses. The appropriateness of any approach depends on a long list of factors, some of which include resource availability and supervisory capacity, maturity, performance and structure of the credit union sector, and its economic potential. Poprawa (2009) highlights the following approaches to regulation: direct supervision, direct supervision of the largest credit unions, delegated supervision, and restructured Ministries.

Direct supervision tasks the authority supervising the other financial players in the economy to include credit unions as well, given their expertise and resources to undertake this supervisory role. In Fiji, this body would be the RBF. However, credit unions' insignificant share of total assets of the financial system nullifies the need for the RBF for prudential supervision of this sector. Moreover, implementation of a broad regulation used to supervise other financial intermediaries in the country has the risk of imposing regulatory structures unsuitable to operations of credit unions.

Since credit unions are distinctive from other providers of credit, they need a regulatory framework that tailors these distinctive characteristics. According to Greuning et al (1998), the principal drawback to blanket regulation is the potential repression of the innovation and flexibility possible with informality. Therefore, should Fiji adopt direct supervision, the RBF together with other stakeholders (FSCUL, credit unions, government ministries) will need to design a regulatory framework that correctly balances appropriate regulation and sustainable development of the credit union sector distinct from the frameworks used to supervise other financial players, together with flexibility to recognize and differentiate between small and large credit unions. Given the large number of geographically dispersed credit unions and the vast difference in terms of maturity, operational capacity and development, a uniform regulation of all credit unions will be a challenging task, to both the RBF and the credit

unions. The less developed credit unions will need assistance to change/amend their current approaches so as to adhere to the regulatory requirements of the supervisory authority.

In light of this, alternatively, the RBF could supervise the larger credit unions and delegate the supervision of the relatively smaller credit unions to a third party. The RBF would then need to develop certain thresholds (in terms of asset size, scope of operation and risk taking) that would trigger or signal the need for a particular credit union to be externally supervised by them. This approach reduces the demand for resources from the RBF by limiting focus on the larger credit unions which are involved in more risky activities and could present problems if failed. It is also more appealing given the large number of geographically dispersed credit unions with different levels of maturity, membership and asset size, scope of operation and risk activities.

Delegating supervisory authority to a third party is yet another option that could be adopted. This, however, has its limitations. The third party could be an authority responsible for growth and development in this sector. On a positive note, this would reduce the burden on government and result in closer feedback between the credit unions and their supervisor, and could be a self-funding approach through compulsory membership. On the downside, the effectiveness of this approach depends on the legislative powers delegated to this third party and the strength of its internal governance. Also, conflict of interest, capacity and resource constraints could also undermine effectiveness. For instance, the FSCUL is already providing development assistance to affiliated credit unions with support from the OCCUL and WOCCU, who promote credit union development in the region and globally. However, membership is not compulsory and the FSCUL scope of operation is also limited to operational and development assistance only.

## Conclusion

The credit union movement in Fiji is in need of immediate attention. Irrespective of their relative asset size and, therefore, the insignificant threat to the soundness of the financial system, the inherent potential (as demonstrated by the larger credit unions) and the current weakness cannot be ignored. In light of this, the following are proposed.

First, the credit union act should be reviewed. The current regulatory framework for credit unions is outdated with no supervision of their financial performance. There is an urgent need to make the provisions of the act more proactive in terms of creating a sound and viable environ-

ment for the credit union sector. The act should be reviewed to include mandatory standards for prudential behaviour, standardized audit and accounting system, enforcement, supervisory and consumer protection regulations.

Second, the industry is in need of external supervision. The WOCCU maintains that credit unions supervised by their financial sector regulator enjoy greater public confidence which increases membership and savings growth. But insignificant threat to Fiji's financial system, vast disparity in size, operation and performance, together with resource constraints nullify the need for prudential supervision by the RBF. External supervision could be delegated to a third party. Furthermore, in line with RBF's commitment to enhance microfinance and microenterprise development and the factors discussed above, the central bank could collaborate with this delegated third party to ensure effective supervision and growth of this industry.

Third, possible merger of smaller poor performing credit unions with the more successful credit unions should be explored. Few credit unions with strong internal governance processes and outcomes have developed significantly, widened their scope of operation, and risk-taking, and are enjoying higher returns. On the other hand, there are selected credit unions whose performance and scope of operation remains narrow, serving the principal purpose of saving and lending, while a large number of credit unions are now inactive due to financial failure<sup>8</sup>.

Both internal and external regulations are essential and closely related, since the effectiveness of the second is highly dependent on the first. Appropriate amendments to the current credit union act will strengthen internal governance, while external supervision (delegated to a third party) would ensure enforcement and monitor financial performance, thus supporting future growth in this sector. The number of credit unions in Fiji has fallen dramatically over the years, together with a substantial decline in the market penetration ratio. Employer related common-bond credit unions are more prominent while community level credit unions are either on the decline, weakly active or inactive. Other country experiences imply the credit union philosophy is still an effective means to pool resources and improve economic conditions, which grounds the need for a review of the current credit union act and the need for an effective supervisory body.

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<sup>8</sup> According to the Registrar of Credit Unions and the FSCUL, records show around 400 credit unions registered, however, there is no information on how many of these are currently active and how many have financially collapsed.



**Appendix 1:****FSCUL member credit unions and membership size as at June 2012**

Credit Union	Members
Fiji Teachers Union Co-operative Thrift & Credit Ltd*	3600
Fiji Public Service Credit Union (FPSCU)	2550
Service Workers Credit Union (SWCU)*	2318
Fijian Teachers Association Credit Union (FTACU)	2000
Fiji Police Credit Union (FPCU)	1300
Fiji Nurses Association Credit Union (FNCU)	1200
Pacific Fishing Employees Credit Union (PECU)	500
Air Terminal Services Staff Credit Union (ATSCU)	350
Fiji Post and Telecommunications Credit Union (FPTCU)	350
Fiji Prison Service Credit Union (FPSCU)	350
Vatukoula Mineworkers Credit Union	200
Public Employees Credit Union (PECU)	180
Mana Island Resort Employees Credit Union (MIRCU)	172
Good Samaritan Credit Union (GSCU)	150
F A B Employees Credit Union (FABECU)	120
Fintel / Cable & Wireless (FCWCU)	117
District Engineer Lautoka Credit Union (DELUCU)	100
Lautoka Mill Credit Union (LMCU)	100
Sacred Heart Parish Credit Union	100
Viti National Union Taukei Credit Union (VCU)	80
Rewa Co-operative Dairy Credit Union (RCDCU)	50
Samabula Depot Employees Credit Union (SDECU)	50
Fijian Hotel Staff Employees Credit Union (FHSCU)	50
Housing Authority Employees Credit Union (HASCU)	50
Tamavua Hospital Workers Credit Union	50
Humes Industries Employees Credit Union (HIIECU)	35
Fiji Meat Industry Board Employees Credit Union (FMICU)	20

\* These two are non-FSCUL members; others are FSCUL members. (Source: FSCUL, FTU-CTCL & SWCU Annual Reports)

**Appendix 2:****Gross Assets of Fiji's Financial System: 2011(p)**

Regulated financial entities	\$Fm
Commercial banks	4,954
Credit institutions	447
Insurance companies	1,051
Fiji National Provident Fund	4,015
<b>Total</b>	<b>10,467</b>
<b>Non Regulated Financial entities</b>	
Non-Bank Financial Institutions	651
<b>Total</b>	<b>651</b>
<b>Total Financial System</b>	<b>11,118</b>

(Source: Reserve Bank of Fiji Annual Report 2011)

**Appendix 3:****Formulas for calculation of ratios in Table 4**

RATIOS	FORMULAS (Multiply all by 100)
<b>Capital Adequacy</b>	
Capital/Assets Ratio	Total capital/Total Assets
<b>Quality of Assets</b>	
Net Profit/Assets	Net Profit/Total Assets
Operating Expense/Assets	Operating Expenses/Total Assets
Fixed Assets/Assets	Fixed assets/Total Assets
Non-Performing Assets/Assets	Non-performing assets/Total Assets
Earning Assets/Assets	Earning Assets/Total Assets
<b>Liquidity</b>	
Current Liquidity Ratio	liquid assets/relevant liquid liabilities
Savings To Loans Turnover	savings/loan
<b>Efficiency</b>	
Loans/Assets	loans/total assets
Borrowed Funds/Assets	borrowed funds/total assets
Income Gaining Assets/Cost	earning assets/cost bearing liabilities
Bearing Liabilities	
Members Shares/Total Assets	Member shares/total assets

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