



FALKLAND ISLANDS CREDIT UNION SUSTABILITY STUDY

PHASE II - PUBLIC CONSULTATION

DETERMINE IF THE PUBLIC BELIEVES THERE IS A NEED FOR
ALTERNATIVE FINANCIAL SERVICES IN THE FALKLAND ISLANDS

JANUARY 17, 2014

PREPARED FOR:
FALKLAND ISLANDS
DEVELOPMENT
CORPORATION AND
WORLD COUNCIL OF
CREDIT UNIONS

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CREDIT UNION SUITABILITY STUDY – PHASE II

OVERVIEW OF CONSULTANCY

The second consultancy period in the Falkland Islands was held October 26th through November 3rd, 2013. Travel and lodging expenses were provided by the Falkland Islands Development Corporation (FIDC) in support of their efforts to gauge public interest for a credit union in the Islands. Dwayne Naylor, World Council of Credit Unions (WOCCU) Consultant, worked closely before and after the consultation with Michael Betts, FIDC Business Relations Manager, and Joshua Peck, FIDC Development Intern.

Mr. Naylor served again in a volunteer capacity representing WOCCU. His salary was provided by his employer, Local Government Federal Credit Union and WOCCU provided resources, expertise and travel insurance. The previous consultancy period in April 2013 included meetings with elected officials, Falkland Islands Government (FIG), trade associations and business leaders in the community. The Credit Union Suitability Study provided enough support for FIDC leadership to approve further investigation of alternative financial services in the Islands.

During Mr. Naylor's second week in the Islands he met with Keith Padgett, FIG Chief Executive (CE), Justin McPhee, Manager of Sure South Atlantic, Jamie Fotheringham, FIG Head of Policy, Lydia Morrison, FIG Head of Finance, Mark Lewis, FIG Attorney General, Falkland Islands Fishing Company Association (FIFCA) and the Falkland Islands Chamber of Commerce. Mr. Naylor also held interviews with the newspaper, Penguin News, Falkland Islands Television (FITV) and the Falkland Islands Radio Station (FIRS). All three news outlets provided coverage of the public presentations as well as the need to complete the credit union survey that was being circulated. Public presentations were held at the Chamber of Commerce in Stanley and Goose Green. The final conversation was held with Sandra Taylor-Hayward, Acting Governor of the Falkland Islands.

REQUIREMENTS FOR SUCCESS – OUTLINED IN PREVIOUS REPORT

As identified in the first study, all of the Requirements for Success items were the same, such as the need for Capital funding, deposit insurance and strong regulation. Listed below are the keys to success outlined in the first study:

1. Community adoption of the credit union
2. Committed and sustained local board leadership and management
3. Capital injection and support from FIG through FIDC
4. Deposit Insurance from FIG or capital injection to offset risk perception

5. Transfer of loan base from FIDC to the credit union
6. New credit union legislation - could be an amendment to The Banking Ordinance of 1987
7. Credit union regulation and oversight
8. Telecommunication solution – stable and cost effective
9. External accounting firm for auditing function

GOVERNMENT AND COMMUNITY LEADERSHIP INTERVIEWS

Conversations with government and community leaders were direct, honest and genuinely positive. This report provides a high level overview and does not include individual comments for the purpose of this report. Therefore, the opinions in this section are the consultant’s understanding of the main issues that were shared. While collectively most were in support of the idea and discussed many of the challenges in the first report, they acknowledged that a detailed business plan was needed to establish a strong position. Everyone that we interviewed had studied the Credit Union Suitability Report and was well prepared for a discussion of the key issues.

- Sure South Atlantic stated that the first report was incorrect and that they could provide affordable and reliable connectivity.
- Legislation could be addressed if FIG made the credit union legislation a priority.
- Regulation and the cost of providing oversight was a concern and guidance was needed. Concern was expressed with the FIG’s capacity to administer a regulatory function with the current workload.
- Deposit Insurance - No determination was made on the feasibility of deposit insurance, but this will be required to establish public confidence. It was noted that consideration of offering deposit insurance without a large pool of financial institutions to mitigate risk was a concern.
- FIG - A detailed business model was needed to consider supporting the initiative. Representatives at FIG appeared genuinely supportive of the concept. It was emphasized that transferring loans from FIDC may be problematic, as any losses would require support from FIG.
- Business Leadership – The leaders that were interviewed were generally supportive of the concept and the possible access to alternative financial services.
- Acting Governor – A detailed discussion was held regarding the initial financial forecast and the need for a business plan. The position of the Governor’s office is

one of caution as any increase in risk of contingent liability is a concern for the British Government and may not be supported.

INFORMING THE PUBLIC

Preliminary work was provided by FIDC to educate and inform the public about credit unions and the public sessions that would be held in Stanley and Camp.

Interviews were held with the three main local news outlets in the Falkland Islands. The Penguin News article, see attached, **Schedule A**, provides an overview of the topics discussed during the radio and television interviews.

TOPICS COVERED

The purpose was to educate the public on the credit union model in preparation of the public consultations. It was emphasized through all media channels that honest feedback and participation in the public forum and subsequent FIDC survey would play a significant role in the credit union decision to continue the project or not.

- What was the appetite for additional financial services in the Islands? Will the community support a financial cooperative?
- Two public consultations were held at the FI Chamber of Commerce in Stanley where nine attended, and 17 attended the presentation at the Social Club at Goose Green in Camp.
- What is a credit union? It was acknowledged that it is difficult to know if you are interested in a credit union if someone has not previously experienced the credit union model and services. An overview was provided to create an understanding of the breadth of financial services that may be offered.
- The top four challenges identified in the first study were discussed: capital, regulation, legislation and deposit insurance.
- The importance of the public's active participation in the public presentations and the subsequent credit union survey would ultimately influence the decision to move forward or stop the project.

PUBLIC PRESENTATIONS

The public presentations were reasonably well attended and many questions were presented from participants that were running for elected office, as an election was being held in the Islands in a couple weeks. Attendance levels may have been adversely affected by the lead up to the 2013 Election.

- The main question asked during the public consultations was, “What level of interest does the community have for additional financial services in the Falkland Islands?”
- The focus on the credit union model versus other financial institutions is because of the business model. Essentially, the governance of the credit union is managed by the very people it serves, its members – Local ownership, local leadership and local decisions.



Michael Betts speaking at The Social Club at Goose Green

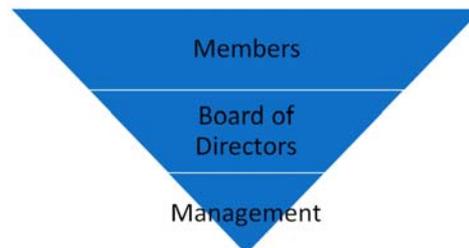
Listed below is a diagram that was shared in the presentation that depicts the difference in governance models between banks and credit unions. The governance model for a credit union is inverted, as the board and management work for the members as they own the institution. At a bank, stockholders correctly have a vote on the actions of a bank based on the number of shares they own. In a credit union, each member has an equal vote in how the organization will be governed.

Credit Union versus Bank Governance Models

Banking Structure – For-Profit



“Members are the Boss” One member – One vote



- A locally owned institution allows for revenue to stay in the Islands through reinvestment of resources in the community. The chart below was shared with the public, which depicts the cyclical nature of reinvestment in the local economy. The credit union would provide economic stimulus in the local economy. A credit union could not replace the existing banking services. The credit union would ultimately support a generation of new businesses produced by a growing economy. The expansion of the economy through access to credit, would essentially expand the size of the pie and along with it, business for the bank.

All revenue from the Credit Union and Members remain local



- Market Need: The following areas of service were identified by the public for improving financial services in the Islands: extended hours of operation, greater access to credit/loans, reduced collateral/security on loans, competitive rates on deposits, competitive rates on loans, lower fees and an ATM.
- The ultimate goal is self-sustainability of a financial cooperative
- The size of the Falkland Islands market was a repetitive concern during the public consultations. Listed below is a chart outlining a case study used in the presentations and the previous report to demonstrate multiple financial institutions can be successful in a market similar to the Falkland Islands.

Falkland Islands / Saint Pierre and Miquelon Comparisonⁱ		
	Falkland Islands	Saint Pierre and Miquelon
Population	2,500	6,000
Geography - Area	12,173 sq km	242 sq km
Urbanization	74%	91%
GDP per Capita	£36,000	£23,000
Primary Industry	Fishing	Fishing
Other industry	Farms, Sheep	Farms, Sheep
Hydrocarbon Industry	Hydrocarbons discovery	Hydrocarbon exploration
Banks*	1	3
Credit Unions*	0	1
Finance Company	0	1
# Branches*	1	6
# Branches per person*	2,500	1,023
ATMs*	0	4
# of ATMs per person*	0	1,531

ⁱ Central Intelligence Agency Factbook: <https://www.cia.gov/library/publications/the-world-factbook/geos/sb.html>

PUBLIC RESPONSE AND SURVEY RESULTS

The consultation included a brief survey. The purpose of this survey was to garner specific views of members of the public with regards to the suitability of a credit union being established in the Falkland Islands. The detailed analysis in Michael Betts' survey results report will not be repeated in this report. Mr. Betts states in the report it is difficult to determine if the 52 completed surveys accurately reflect the position of the Falkland Islands' population. That being said, the results of the survey are overwhelmingly conclusive to the primary questions of the consultation, as follows:

- **What was the appetite for additional financial services in the Islands?**

96% of the respondents stated there was a need for additional financial services. Statistically, even with a large margin of error this finding is conclusive.

- **Will the community support a financial cooperative?**

77% of the respondents stated they would open a personal and 44% would open a business account. This feedback translates to 48 out of 52 respondents stating they would open a personal and/or business account. These conclusive results mirror individual conversations we have had with community and government leaders.

54% of the respondents stated they would use the credit union for their personal borrowing needs and 40% for their business borrowing needs.

£1,065 – This is a conservative average of the initial deposit the respondents stated they would make at the Falkland Islands Credit Union. It is noteworthy that when

calculating the average deposit, the high range, representing 10 respondents that would deposit £5,000 plus, was not included. The average of £1,065 far exceeds the conservative assumption of £500 used in the financial forecast model created in Phase I.

The number of completed surveys, 52, represented almost twice the number of Islanders that attended the public presentations. During the public presentations there were relevant challenging questions asked from the floor that gave the appearance that the community doubted the ability of Islanders to effectively manage their own financial institution. The results of the survey were somewhat surprising, as the recruitment of board members and management were listed low in the question concerning barriers to success.

The results of the survey fully support the opinions expressed in public and private conversations held during the two weeks of consultations in April and November.

SUMMARY OF FINDINGS

During the Phase II study, five challenges surfaced consistently from audiences that should be addressed further. It should be noted that the general expression of the attendees at the sessions was positive and why challenging issues were addressed, the groups were consistently supportive of the credit union concept.

1. Leadership. Community leaders need to step up and commit to taking ownership of the establishment of the credit union. It is normal for a sponsoring organization, like FIDC, to be the initiator. Ultimately, public opinion will be moved by a few highly supportive leaders. If a group of supportive volunteers were recruited in the next phase, they may be able to overcome the hurdles of public speculation, capital, regulation, etc. To be fully supported by the community it will be important that Islanders will need to be in leadership roles during the process. It may require a contract employee with financial institution experience to be recruited initially to build the public's confidence. An identified Islander can shadow the manager for succession planning. There appeared to be lack of confidence from the community that local leaders would step up and serve the credit union as dedicated volunteers and this is an area that needs to be addressed.

Community leaders will need to engage and accept responsibility for moving the credit union concept forward to ensure success.

2. Market size— During the discussion with leaders and the public, many asked questions about the size of the Falkland Islands' market size. The examples of market size provided in the first suitability study, St. Pierre Miquelon and 1,500 credit unions in the United States with

an average of 700 members were used in the response. It was apparent that the examples used, were not sufficient to build confidence during our sessions for many. Mr. Naylor responded considering the expected economic growth in the Islands, the question was not if an alternative financial institution would be established in the Islands, but when.

3. Competitive Reaction – Many questions relating to Standard Chartered Bank’s response to competition demonstrated uneasiness about the possibility of losing the bank that has contributed significantly to the Islands and is an important part of its history. The questions were fair and relevant, but the response included that with the expanding economy, at some point a competitor will enter the market. Why was there confidence in another bank and not a locally owned and operated credit union? It appeared the general assumption was that deposit insurance of Falkland Island deposits was not required by large international banks serving the Falkland Islands. It seemed the perception of safety and soundness of international banks may have been established by Standard Chartered’s performance during the Great Recession with no deposit insurance. History has proven large financial institution can fail and deposit insurance would mitigate the risks of future losses at any financial institutions servicing the Islands, including a credit union. Furthermore, internationally, credit unions and cooperatives performed very well during the Great Recession, as their focus was serving members.

In addition, the credit union would not be able to provide many services that a large international bank can provide. There should be many opportunities for the credit union to partner with the bank to address these concerns. Again, these questions were on point and a respectful partnership and working with the Standard Chartered Bank throughout the process will be important.

The community needs to grow confidence in their ability to govern, manage, regulate and support their own financial institution.

4. Capital: Several government officials supported the idea; however, the Acting Governor, Sandra Taylor-Hayward, stated she was very much against any idea that increased the contingent liability for the UK. Sandra is appointed by the British Government for a three-year term. Her and the Governor’s office’s primary responsibility is to represent the British Government in the Falkland Islands, which includes the contingent liability factor. She provided examples of other islands having to be bailed out and stated that the Falkland’s are financially self-reliant and the British Government wishes it to remain that way. This position is fully understood considering the Acting Governor’s responsibilities and the past instances of other British Territories requiring British Government assistance. Historically, a

new initiative requires foreign investment. The credit union's requirement of a capital injection represents a long term investment to grow the economy, which is requires a different perspective.

The reality is if significant capital is not invested to in the credit union the establishment of a credit union will not be possible.

5. Detailed Business Plan – A need for a detailed business plan was emphasized by Keith Padgett, FIG CE. He stated it was critically important for FIG to have a deep understanding of the credit union model and the expected breakeven period before any consideration. This desire was echoed by other officials and candidates for office that attended the public credit union forums. If the credit union initiative moves forward, the plan is to provide a business plan in Phase III. A financial forecast was provided in Phase I. It is expected that results of the survey in Phase II, will aid in redefining the model's assumptions.

A business plan provides a framework but does not ensure success. Success requires leaders committed to a cause with the courage to do the right thing.

It is important to note that business plans will never be exact and completely predict the future. Skeptics, which serve an important role, will challenge model assumptions and advocates may be overly optimistic. The responsibility for modeling is to be fair and conservative in the assumptions. Furthermore, a financial forecast will be challenged by market responses, just like any other business. The credit union's success will rely heavily on the board and management's response to challenges and opportunities to ensure soundness and quality service. As Mr. Naylor responded in public presentations, strong leadership reacts and makes decisions to be successful. Any business' success relies on leadership and doing the right thing.

RECOMMENDATIONS – NEXT STEPS

As expected the conversations with government and community leadership were more direct about the challenges of starting a Falkland Islands financial institution. The collective positive

responses and opinions expressed in interviews and public consultations support the recommendation is to move to Phase III of the credit union suitability study:

1. Business Plan – Build a workable business plan to address breakeven forecasts that support the sustainability of the business model.
2. Leadership – Recruitment of community leaders that will work closely with FIDC and own the project.
3. Capital and Deposit Insurance – Determine if FIG will at least consider funding capital and providing depositor’s insurance for the new credit union, if a strong business plan supports the model.

WOCCU SUPPORT

As the world’s leading advocate, platform for knowledge exchange and development agency for credit unions, World Council collects credit union best practices from around the world and makes them available to regulators, policymakers, second-tier credit union organizations and individual credit unions.

WOCCU has assisted credit unions internationally to organize and establish best practices. WOCCU provides support and research relating to organizing a credit union and model regulation and legislation. Principles documents based on international experience are provided for consumer protection, operating procedures, governance and safety and soundness. This international experience is used to emphasize proven methods for establishing effective governance, transparency and safety and soundness. If the credit union initiative moves forward, Mr. Naylor representing WOCCU, commits to working with FIDC to build the credit union business plan and forecast modeling for Phase III. While WOCCU’s purpose is to assist in building sound financial cooperative to improve the lives of their members internationally, the responsibility of success will always reside with passionate local leaders that have built effective partnerships with government.

ABOUT THE AUTHOR

Dwayne Naylor is the Chief Operating Officer (COO) at Local Government Federal Credit Union (LGFCU). He most recently worked as Executive Vice President at Langley Federal Credit Union in Virginia before returning to LGFCU where he previously had served as Executive Vice President. Naylor earned a Global MBA from The Fuqua School of Business at Duke University. He also received a Bachelor of Science from East Carolina University. He holds the Certified Chief Executive (CCE) designation, Certified Credit Union Executive (CCUE) and Credit Union Development Educator (CUDE) Naylor has contributed and been a supporter of several WOCCU initiatives.

SCHEDULE A

Credit Union a viable financial services option for Falkland Islands?

- Created
Thursday, 31 October 2013 - Penguin News, Page 1
 - Last modified
Thursday, 31 October 2013
 - Categories
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A LOCALLY owned and managed credit union, "run by the people that it serves," that would provide savings, credit and other financial services to its members, is the subject of a newly released suitability study by the Falkland Islands Development Corporation (FIDC) and was discussed at public consultation meetings at the Chamber of Commerce and the Goose Green Social Club this week.

Dwayne Naylor of the World Council of Credit Unions, who produced the report and is currently in the Falkland Islands, last visited in April (as reported in Penguin News at the time) when he discussed the concept with both Government and the private sector. FIDC Business Relations Manager Michael Betts told Penguin News that in this next step they were looking to, "both Stanley and Camp," for feedback, "because both of them have similar perceived issues with access to finance and financial services."

At this week's meetings apart from obtaining input regarding whether there was an "appetite" for such an institution, the intention was to, "paint a picture," of what a credit union looked like, said Mr Naylor. He explained that in the Falklands most Islanders had not seen a credit union working.

He described the institution saying: "One of the main differences is that in a normal organisation you have stock holders at the top who invest money and want a return on their money, and you have the Board of Directors and you have management."

In a credit union the triangle is inverted: "At the top you have the members who elect a voluntary Board of Directors that manages at the bottom of the pyramid, so all earnings that are created through that entity are returned to the members who are the owners of the organisation."

The volunteer Board of Directors is required to respond to the members in a fiscal responsible manner to provide the services that they want, he explained: "So in the Falkland Islands if the members say I want an ATM the management has to work towards that to provide that ATM."

He said he had put ATMs in places that had lost money, "but the Board said that is what we have to do to respond to our membership."

Mr Betts expanded explaining this was why a credit union seemed appropriate because, "the members choose the Board and the Board sets the policy and the rates and what services were provided," and as such it was, "more in touch with what the community needs in terms of financial services."

Speaking of research into the suitability of a credit union in the Falklands, Mr Naylor said: "One of the things we had to look at was whether the Falklands market was large enough to support two financial institutions." It was concluded that it was, and Mr Naylor said: "There are 2,100 credit unions in the US that have less than 1,500 members; they average about 700 members and most of those are in very small communities. Most want to stay small on purpose, offer a service but not expand beyond their primary membership."

Also vital to the success of the credit union is, "adoption," by the community: "If Islanders accept and support the institution it will be successful," he said.

Initial capital and a deposit insurance to mitigate not just risk but strengthen the community perception of a credit union is also important. Source of that initial funding is likely to be a, "political decision," however, said Mr Betts. According to the report it could be funded by FIDC or government as one of the options.

The success of the credit union also requires effective legislation and regulation. Mr Naylor said: "A transparent credit union requires a very strong regulator."

Local ownership fits well with the Islanders' strong sense of national pride said Mr Naylor. He has seen this in communities before "and is actually why I have stayed in credit unions for thirty years."

He added that the, "timing of an alternative source of finance could not be better in front of the economic expansion. This is not supposed to replace the local bank, which has had huge historical value to the Falkland Islands it is just an alternative form of finance and deposit. And in the credit union model, if you do not have to pay the stock holders, then the beauty is that there should be a higher rate paid on deposits and

a lower rate paid on loans since all of that revenue is being returned to members in forms of services and products."

Mr Naylor said when examining the model for the Falklands credit union Michael had made sure they had been, "very conservative," in their assumptions.

A survey will be circulated in the Islands and the feedback received will impact very much on the next stages of the project said Mr Betts, adding, "but if they don't think credit unions are the way forward we will have to look at other ways."

The next step for the concept is to examine, "will it be viable," said Mr Betts, "because we don't want another organisation that is subsidised or receives a subvention, it wants to be funding itself otherwise there is no real point to having it."

The public consultation ends on the November 29 and copies of the report, survey and public presentation are available upon request from FIDC.