Registry of Credit Unions
Central Bank of Ireland
PO Box 559
New Wapping Street
North Wall Quay
Dublin 1

27th June 2017

Dear Sir or Madam,

The Board of Directors at their meeting of 26th June 2017 have asked that we express their extreme displeasure with many of the proposals contained in the Central Bank of Ireland Consultation Paper CP109.

In summary these proposals;

- will significantly impact the viability of Ardee Credit Union going forward
- adversely affect the projections which underpin our Strategic Plan
- will take away 70% of our investable assets
- will mean that we will no longer be able to invest in senior bank bonds which as of 31.05.17 comprise 39% of our investment portfolio.
- would lead to a projected loss of income on our maturing bank bonds in the amount of €401,000, a reduction of 22% in our overall projected income over the term of our Strategic Plan
- the restriction of counterparty exposure from 25% to 20% will further complicate the challenge of planning short term deposits

Some of the proposed changes would seem to be most unfair to the Credit Union movement and it would appear that the Central Bank, the body tasked with the responsible for regulating Credit Unions, is now seeking to frame our investment strategy. Our answers to the specific questions raised are contained in the Appendix to this letter.

Yours faithfully,

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Niall Lambert,
Manager,
Ardee Credit Union Ltd

Appendix 1

1. Do you have any comments on the current level of diversification in credit union investment portfolios? Are there any barriers to the use of existing diversification options within the current investment framework? If so, please provide details and any suggestions to address these.

   The current level of diversification reflects rational allocation of investments given the returns available. The CBI in CP109 makes no reference to returns other than the fact that the level of return is not a consideration when deciding on the appropriateness of an investment. If returns are inconsequential then why invest at all? There is a requirement to consider returns to ensure the credit union remains viable as per regulatory and member requirements. It is unrealistic to suggest that returns can be ignored in the context of considering investments and at the same time suggest the inclusion of 25 year investments and riskier corporate bonds.

   There are unprecedented reinvestment risks in the sector given falling deposit rates and the proposals in CP109 will exasperate these risks, as Ardee Credit Union Credit Union seeks returns to secure our viability. Ardee Credit Union will potentially become more vulnerable through these proposals, to increasingly risky counterparties in an effort to secure minimum required returns in the current environment.

2. Do you have any comments on the potential introduction of additional investment classes for credit unions and the appropriateness of the classes being considered by the Central Bank?

   While we welcome the addition of alternatives to the current investment options available to Ardee Credit Union, the addition of the suggested investment classes adds little to our reinvestment challenge, given the suggested restrictions in the maximum percentage of investments that will be available for consideration.

   The inclusion of these new asset classes which introduce some new risks to Ardee Credit Union would need to be considered carefully in the context of each investment portfolio. The new categories also reflect an inconsistent approach regarding risk. On one hand there is the removal of senior non-preference bank bonds within a highly regulated sector, and on the other the introduction of 25 year investments which provide no liquidity. Risks are further compounded with the inclusion of unregulated corporate bonds with demonstrable higher default rates. Both of these categories arguably introduce specific and varied investment and liquidity risks to investment portfolios particularly when compared to highly regulated,short duration senior non-preference bank bonds.

   We would ask for clarification on whether the definition of regulatory reserves referred to in CP109 refer to the 10% minimum reserve requirement or will we have the ability to include any excess reserves above the minimum when calculating the maximum exposure for a particular asset class as per the limits suggested in CP109? Will all available reserves count for consideration?

   Also regarding Corporate bonds will “A” rated holding company bank bonds qualify as corporate bonds under the proposed CBI definition of corporate bonds?

3. Taking account of the appropriate risk profile for credit union investments, are there any additional investment classes that the Central Bank should consider? If so, please outline the investment classes and why such investment classes are considered appropriate for credit unions.

We would suggest that credit unions could invest in specific semi-state entities and provide funding up to 10 years as appropriate capped to 25% of investments.

This would allow the CBI to maintain this list of approved entities. Similarly, to the social housing proposal it would allow Irish members funds to be invested in the state in support of local enterprise and developments.

4. Do you have any comments on the potential to include supranational bonds in the list of authorised classes of investments set out in credit union investment regulations with a minimum credit rating requirement and maturity limit?

To limit this asset class to a maximum of 50% of regulatory reserves, would equate to a maximum exposure of 8.3% of investments as per the CBI analysis. While we would welcome the inclusion of additional counterparties, the inclusion of supranational bonds does not diversify the underlying counterparties available as the eligible instruments are likely to be backed by European sovereigns and the quantum suggested will add little by the way of diversification.

5. Do you have any comments on the suggested concentration limit for credit union investments in supranational bonds? If you have suggestions, please provide them along with supporting rationale.

We would recommend increasing the quantity to a percentage of investments as opposed to a percentage of regulatory reserves. This would be consistent with the existing methodology employed by the central bank for the purposes of prudential returns.

Issuer	Rating (S&P)	5 Year	7 Year	10 Year
EIB	AAA (Fitch)	-0.14%	0.14%	0.46%
EFSF	AA	-0.11%	0.22%	0.66%
EU	AA	-0.21%	0.02%	0.57%

Source: Bloomberg

Given the ratings of existing Supranational bonds in issuance and the yields available, any investments are likely to be of the longest available duration locking in low yields and adding to the mentioned imbalance between assets and liabilities.

6. Do you have any comments on the potential to include corporate bonds in the list of authorised classes of investments set out in credit union investment regulations with a minimum credit rating requirement and maturity limit?

If Ardee Credit Unions begins investing in Corporate Bonds it will in practice be to search for yield and not for any theoretical diversification of risk. The proposed cap of 25% of our regulatory reserves will promote concentration risk in the least desirable A rated corporate bonds with the highest yield. It is a likely outcome that we may unwittingly place 25% of our regulatory capital at undue risk.

Multi-year default rates are more relevant than annual default rates for measuring trends in aggregate credit quality, specifically for investors with longer investment horizons. If we assume that the Credit Unions would hold Corporate "A" rated bonds for 5 years; then recent history suggests a 1.76%[1] default in "A" rated corporates. This compares to near zero for historic senior bank bonds.

European and global issuer-weighted cumulative default rates, 1985-2015H1

Europe										
Rating\Year	1	2	3	4	5	6	7	8	9	10
Aaa	0.00%	0.04%	0.04%	0.04%	0.04%	0.04%	0.04%	0.04%	0.04%	0.04%
Aa	0.03%	0.09%	0.14%	0.22%	0.34%	0.49%	0.68%	0.85%	0.96%	1.08%
A	0.15%	0.36%	0.75%	1.18%	1.76%	2.39%	3.02%	3.66%	4.43%	5.26%

Source: Moody's

This reflects an inconsistent application of what constitutes an appropriate risk, as per section 43 regarding investments and the use of members funds. If the historic data is to be a guide then Corporate bonds should be limited to AA rated and Bank bonds should be included and limited to A rated to reflect their highly regulated status and to be consistent and reflect a similar risk.

7. Do you have any comments on the suggested concentration limit for credit union investments in corporate bonds? If you have suggestions, please provide them along with supporting rationale.

We would not be in favour of direct holdings in Corporate bonds for the reasons outlined above. If an investment is prone to a risk of capital loss as a matter of course then it should not be deemed appropriate for our investment portfolio. Where we may be inclined to look for yield there may be a natural selection bias towards the highest yielding qualifying corporate bond. In the unregulated space of corporate bonds this will increase our investment risk in correlation with the business and interest rate cycle. This will be at complete variance to our investment risk appetite.

We would suggest that the benefit of diversification is obvious and necessary when investing in corporate bonds and use of a collective investment scheme with strict concentration and maturity limits would be the best way to invest in these funds. Potentially increasing the asset class size to 20% of investments and limit any individual credit exposures to 1% of investments. These qualifications would allow for the scale necessary to create diversified portfolios of suitable corporate bonds. This would help mitigate default risk and the risk of selection bias towards the highest yielding qualifying bonds.

8. Do you think it is appropriate for credit unions to undertake investments in AHBs? If so, please provide a rationale.

We welcome the opportunity for Ardee Credit Union to invest in Approved Housing Bodies. However, we would need to know the level of return and the likely risks involved over the term of the investment. Furthermore, we would need to be able to demonstrate an understanding of the default risks and the likely timing of returns to be compliant with Section 43 of the 1997 credit union act.

9. What would the most appropriate structure for investments in AHBs be e.g. investment vehicle?

In the absence of details on the returns it is hard to be specific on the vehicle. Ardee Credit Union would have an appetite to provide funding to social housing and community oriented investments in our community and for such investments to make an impact locally. Housing these investments

[1] Moody's European Corporate Default and Recovery Rates, 1985-2015 H1

collectively may be more difficult if our Members monies were to be invested away from our local community without any direct input or visibility.

10. What do you consider to be the risks associated with this type of investment and what mitigates do you feel are available to manage these risks?

    Term of the investment, capital risk, liquidity risk, and counterparty risk would all be important considerations.

11. How can the ALM issues associated with such investments be addressed by credit unions?

    It would need to be assumed that the funds would be unavailable for the duration of the investment. This will certainly have an impact on the duration of our portfolio. The limit to 50% of regulatory reserves limits this to a maximum of 10.9% in the examples provided in the RIA. This would appear to be a high percentage if we place to the maximum of 25 years and may not look like prudent use of members funds over the lifetime of the investment.

12. Given the existing mismatch between the maturity profile of the sector's funding and assets and the likely maturity profile of such investments, the Central Bank is of the view that the concentration limit would need to be set at a level that reflects this. Do you have any views on what an appropriate concentration limit would be for such an investment? What liquidity and ALM requirements could be introduced to mitigate these risks and potentially facilitate a larger concentration limit?

    Credit unions are already subject to onerous liquidity requirements. 20% of unattached shares are required as a minimum to be less than 90 day maturities. As per the central banks own commentary "total members' savings in credit unions remained stable during the financial crisis." With the introduction of the €100k government guarantee per person per institution, it appears that the commentary in CP109 overstates the potential risk regarding operating liquidity requirements. The more relevant focus should be on the concentration of investment in specific demographic groups and the likely requirements for these funds in the medium term. just over 2 years. Ardee Credit Union already provides for significant excess liquidity under the current central bank rules.

13. Do you have any comments on the proposal to include investments in Tier 3 AHBs in the list of authorised classes of investments set out in credit union investment regulations with a 25 year maturity limit?

    While we agree with the introduction of the asset class, the extreme duration of the investment would mean that these investments should be scaled in over the medium term. There would need to be a demonstrated understanding that this moment may not be the opportune time in the interest rate cycle to potentially invest members funds for 25 years. This is such an extreme moment in global interest rates. A resolution at our next AGM may be a prudent requirement to seek the approval of members. AHB type investments are a departure from existing investment categories and are more akin to the addition of a new service. Investments of this nature and duration cannot be specifically critiqued as to the prudent use of members funds in the absence of any indication of the likely attributable returns.

14. Do you have any comments on the proposal to amend the existing counterparty limit for credit union investments? If you have suggestions, please provide them along with supporting rationale.

    We would not support an amendment to the current limits at this time. European banking institutions are currently exiting the domestic Irish banking market. Ardee Credit Union is already struggling to preserve capital with negative interest rates being applied by many domestic and most European deposit providers.

15. Do you have any comments on the proposed transitional arrangement to reduce the counterparty limit to 20% of total investments?

    We are not in agreement to the reduction of the counterparty limit of 20% as proposed.

16. Do you have any comments on the use of collective investment schemes for credit union investments?

    If we take the example of deposits or bank bonds, the credit union can capture higher returns by placing or holding these investment instruments directly. The benefit of a collective investment scheme is the provision of diversification of counterparties and the ability to place funds with various maturities.

    The counterparty diversification is a clear benefit but the costs and fees associated with the running of a collective investment scheme could prove prohibitive. In terms of various maturities in a liquidity fund, again with interest rates at zero or below, a fund of this nature is not a workable alternative at this time. The funding of the liquidity cost would be included in the fund and exacerbate the already near or below zero returns currently for short term deposits.

17. Are there any barriers to credit unions using collective investment schemes in the existing investment regulatory framework?

    Currently the returns on these schemes are too small to justify the costs associated with the establishment and running of such structures and the liquidity requirements associated with running these structures.

    There are a significant number of capital preservation, short duration bond funds, that, even though they may be suitable from a risk perspective, would not meet the specific requirements of the credit union regulation.

18. Do you agree with the proposed timelines for the introduction of potential changes to the investment framework set out in this consultation paper? If you have other suggestions please provide them, along with the supporting rationale.

    We welcome the additional categories such as supranational bonds, corporate bonds and AHBs introduced as soon as possible. As outlined above, we believe that any reduction of counterparty exposure limits in the absence of more domestically available deposit providers should not be considered at this time. As set out above we do not support the revised definition of bank bonds described in CP109.