Carrickmacross Credit Union Ltd

Submission on CP109

Carrickmacross Credit Union (CCU) welcomes the opportunity to make a submission on CP109. CCU have considered all of the proposals in relation to the changes of the Investment Framework for Credit Unions and have consulted with our Investment advisors Davy where we collectively identified the direct effects of CP109 on our portfolio. We wish to make the following comments.

Diversification: Initially CCU welcomed the opportunity to invest in new assets classes such as corporate bonds and supranational bonds, however when we examined the concentration limits, which are based on the regulatory reserve, it became clear that the diversification will have little impact on our portfolio. Supranational bonds would represent circa 7% of our investment portfolio and corporate bonds would represent circa 4%.

Investment in AHB's with a concentration limit of 50% of our regulatory reserve would represent just 7.2% of our investment portfolio.

Bank Bonds: The Central Bank's proposal to amend the definition of senior bank bonds will restrict CCU's investment options within this asset class. This proposal will exclude the vast majority of bank bonds. CCU will be limited to investing in covered bonds which represents a small segment of bonds and offer significantly lower yields than those available on senior unsecured bonds.

Social Housing: CCU deem it appropriate to invest in AHB's with a proposed maturity limit of 25 years. There would appear to be a certain lack of detail as to how the investments would be classified i.e. bank bonds or a collective investment scheme.

Counterparty Limit: CCU is strongly averse to the propose change of counterparty limit from 25% to 20%. This proposal will place additional pressure on our portfolio in an effort to reallocate funds within our portfolio to alternative counterparties. The proposed transitional period of 12 months would also be deemed as inadequate.

Liquidity: CCU is disappointed that the Central Bank did not incorporate changes to the liquidity requirements within the consultation paper. There is currently no appetite for short-term deposits. Credit Unions are under severe pressure to retain regulatory liquidity positions given the negative interest rates being charged on bank deposits.

Impact on Income: The consultation paper did not take into account the impact that the proposals will have on Credit Union income. We respect that the Central Bank is not willing to shift the risk appetite for investments in this current low interest rate environment but if the proposed changes to the bank bonds materialises and if CCU allocates funds to the proposed additional asset classes of supranational and corporate bonds, our investment income may decline by up to 23%.

Endorsement of Davy Submission
CCU have reviewed and discussed the Davy submission to the Central Bank and fully endorse their responses and to that end we concur with their responses set out herein.

Responses to the Central Bank's Questions

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.

We agree with the Central Bank that credit union investment portfolios are too concentrated. At present, credit unions have little choice other than to consider cash deposits or bank bonds.

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?

We agree with the proposal to include supranational bonds and corporate bonds. However, the proposed concentration limits by reference to a percentage of regulatory reserves is almost non-material and we propose to switch any change to concentration limits to asset level.

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.

Yes. Certain credit unions should be allowed to invest in senior bank bonds. The RCU should allow credit unions to assess investments (which are within the prescribed classes authorised by the central bank) and decide if they are suitable and based on their own investment objectives.

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?

CCU agrees with this proposal, together with proposed minimum credit rating and maturity limit.

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 oppose the introduction of regulatory reserves as a concentration limit. CCU proposes that the concentration limits on supranational bonds is incorporated into the current asset class level of 70%.

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?

CCU agrees with this proposal, together with proposed minimum credit rating and maturity limit.

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.

CCU propose that the concentration limit of corporate bonds is incorporated into the current 70% asset class limit of bank bonds.

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

Credit unions are a natural investor in social housing.

Appropriate vehicles must be put in place to make credit unions' investment in social housing meaningful, affordable to credit unions and affordable by housing applicants.

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

We feel that special purpose vehicles (SPV's) or collective investment schemes are potentially the most appropriate structures for investments in AHB's. We recommend that the Central Bank opens an application process that accepts proposals with assessments conducted on a case by case basis.

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

Risks associated with investing in this sector may be summarised as, liquidity risk, investment risk, regulatory risk, financial risk and business model risk.

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

CCU believe that the only realistic way of dealing with the ALM issues arising from investments in AHB's is to provide the investment through a collective investment vehicle which is large and accessible to all credit unions.

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?

We recommend a concentration limit of 5% initially to be reviewed for potential upward revision as the sector develops over the next few years. Creating an explicit ALM match for credit unions is problematic. We see the duration of AHB investments as remaining an outlier in ALM terms as it is not possible in our view to duration match AHB investments and the loan book of credit unions. Rather, investment in AHB's needs to be looked at on a portfolio basis and in this context, a 5% weighting will not pose a significant risk in ALM terms, as the overall investment portfolio duration remains relatively short.

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?

For an investment in social housing to be tenable we accept that a term of up to 25 years will be required.

We believe that there may be other options worthy of consideration such as;

A joint development between credit unions and NTMA of a department with expertise in this area

Examination of the market models used in other countries

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 do not feel it is appropriate to reduce the counterparty limit for credit union investments at this time. Diversification proposals in CP109 are insufficient to warrant any contraction in current limits.

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

We would propose a 24 month transitional period but believe that the matter of a transitional period should not arise.

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

CCU advocates the use of collective investment schemes for credit unions.

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

We believe that the barriers are predominantly on the supply side and emanate from the investment environment. Under FRS 102, collective investment schemes must be valued at fair value. Many credit unions hold a preference for valuing investments on an amortised cost basis and are therefore reluctant to absorb the mark to market volatility of collective investment schemes.

It is difficult for advisers to build critical mass to cover and sufficiently dilute the costs involved in setting up a collective investment schemes.

Authorisation process in the central bank may represent a barrier for advisers.

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 agree with the proposed timelines for the introduction of potential changes to the investment framework set out in this consultation paper.

However we would argue that changes are required which are not set out in this consultation paper, particularly in respect of liquidity, and we would urge the RCU to give consideration to implementing these changes ahead of the proposed timeline.

Conclusion

There are significant challenges for all Credit Unions given the current low interest and negative rate environment. We feel that there are considerable implications for Credit Unions and their investment portfolios with the proposals contained in CP109. We would strongly urge the Central Bank to respect the views of Carrickmacross Credit Union in this submission and that due consideration will be given to the impact of the proposals on our investment portfolio.

Marie Brady
Chairperson
For and on behalf of Carrickmacross Credit Union Ltd

26th June 2017