CORE | CREDIT | UNION

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Response to Consultation Paper CP109

28th June 2017

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EXECUTIVE SUMMARY

SUBMISSION FROM CORE CREDIT UNION LTD.

CP109 is the latest in new regulations arising from the Credit Union and Cooperation with Overseas Regulators Act 2012. This act itself follows from the report of the commission on Credit Unions.

The commission report proposed that legislation and regulations be enabling to allow Credit Unions develop their business model.

Credit Unions have invested significantly in risk, compliance and governance systems since 2012. CP109 is a continuation of regulations which, rather than enabling Credit Unions to do more, they are further restricting our ability to generate returns.

Under Section 84 of the Credit Union Act 1997, (" the 1997 Act") the functions of the Central Bank are to administer the system of regulation and supervision of credit unions with a view to the:

- Protection by each credit union of the funds of its members; and
- Maintenance of the financial stability and well-being of credit unions generally.

The former has been achieved by restricting savings to €100,000. The latter is being constantly eroded and CP109 does not improve the well-being of credit unions generally.

While the intentions of the Central Bank are to protect members funds and the motivations behind CP109 are correct, we feel that there are significant unintended consequences that will negatively impact credit unions.

THE CENTRAL BANK IS SEEKING VIEWS ON THE FOLLOWING

POTENTIAL ADDITIONAL INVESTMENT CLASSES

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.

Due to the restrictive nature of current investment regulation it is not possible to diversify credit unions investment portfolios. The most significant barrier is simply the lack of options. CP109 outlines that 73% and 18% of investments are in accounts in authorised credit institutions and bank bonds respectively. This is a total of 91% of our portfolios concentrated in the banking sector. As evidenced in the recent financial crisis the whole banking sector collapsed, therefore, I would argue that counterparty diversification within our portfolios is a futile exercise. In our responses to CP76 and CP88 we have highlighted the importance of meaningful diversification. The outcomes of CP76 and CP88 and this CP have all ignored the principles of portfolio management.

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?

The addition of the proposed additional investment classes is purely cosmetic. These classes will neither reduce our portfolio risk or increase our ability to generate income.

BONDS ISSUED BY SUPERNATIONAL ENTITIES

Due to the continued requirement of the ECB to support banks by continued quantitative easing all investment returns are depressed. Potential availability of supranational bonds will have no positive impact for our portfolios. The proposed concentration limit is also much to low and of little benefit.

CORPORATE BONDS

Corporate bonds are a welcome addition however they are far riskier than traditional Credit Union investments. These will be best managed through a collective investment scheme where much greater diversification could be achieved. The proposed concentration limit effectively rules out this proposed new class.

APPROVED HOUSING BODIES

The consultation paper goes to extreme lengths to highlight the risks of investing in AHBs. We don't foresee this investment class being included in the final regulations, or if they are, the rules will be so restrictive as to effectively rule them out. Therefore, we do not propose on commenting on same.

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.

Safely and prudently management Collective Investment Schemes ("CIS") would allow Credit Unions to collectively participate in a professionally diversified portfolio. These portfolios should be allowed to invest in Property, Equities, Bonds and Cash. The risk appetite of these funds should apply a strict risk management strategy with the aim of reducing risk.

BONDS ISSUED BY SUPRANATIONAL ENTITIES:

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?

In our previous holdings of CISs in the past we were required to 'look through' to see the underlying counterparty to ensure that we were aware of our total counterparty exposures. Applying to same methodology to super national bonds the introduction of these will not truly increase counterparty risk. Ultimately, they will be backed by a European sovereign.

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.

The proposed concentration limits are too low. Percentages should be asset based.

CORPORATE BONDS:

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?

Capping the maximum limit to 25% of regulatory reserves will both prevent us from building up the scale required to ensure that we can apply the appropriate level of diversification to reduce risk. The unintended consequence of the proposed limit will be to increase our portfolio 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.

Our investments are approaching €80 million. The proposed concentration limit will only give us scope to invest €3 million (3.75%) This is not going to contribute to an improved risk managed portfolio.

INVESTMENTS IN AHBS:

8. DO YOU THINK IT IS APPROPRIATE FOR CREDIT UNIONS TO UNDERTAKE INVESTMENTS IN AHBS? IF SO, PLEASE PROVIDE A RATIONALE.

Considering the detail and narrative tone regarding AHB's we cannot see the final regulations providing us with either a workable concentration or maturity limit to make this category viable.

9. WHAT WOULD THE MOST APPROPRIATE STRUCTURE FOR INVESTMENTS IN AHBS BE E.G. INVESTMENT VEHICLE?

A Collective Investment Scheme would be the most appropriate vehicle for such an investment. It would allow Credit Unions to maximise diversification.

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?

CP109 covers in great detail the potential risks with this type of investment.

11. HOW CAN THE ALM ISSUES ASSOCIATED WITH SUCH INVESTMENTS BE ADDRESSED BY CREDIT UNIONS?

Maturity transformation is the cornerstone upon which Savings and Lending institutions are based. We would suggest that the central bank publish a Research Technical Paper ("RTP") studying maturity transformation within the credit union sector. Page 15 of the RIA refers that the ALM mismatch may be somewhat mitigated by relative stickiness of member savings. A RTP would enable informed debate on ALM.

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?

A Research Technical Paper as indicated in question 11 would help towards this debate. The liquidity profile of this investment class would need to be considered also.

Table 9 of the RIA outlines the current maturity profile of the sector which in our opinion overstates the maturity mismatch. Many longer-term investments are held in the form of bank and government bonds which operate in a highly liquid market. Regarding the loan maturity profile, the actual loan duration is significantly shorter than the contract duration which also leads to a distorted maturity profile.

More consideration and analysis is required to make an informed view on concentration limits.

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?

The liquidity of such investments will be critical should they be allowed. Whilst currently we have an over reliance on investments our primary business should be lending. To have any more than 15% of our total assets within this category could create liquidity risk in the future

COUNTERPARTY EXPOSURE LIMIT:

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 currently try to operate to a 20% counterparty limit. In an ideal scenario regulations should not set maximum counterparty as the regulations themselves should ensure best practice portfolio management. Unfortunately our concentration risk to the banking sector is not being addressed in this paper. Based on Chart 6 if we were to exercise full concentration limit for the proposed investment classes we would have a minimum exposure of at least 76% to one sector.

15. DO YOU HAVE ANY COMMENTS ON THE PROPOSED TRANSITIONAL ARRANGEMENT TO REDUCE THE COUNTERPARTY LIMIT TO 20% OF TOTAL INVESTMENTS?

No

COLLECTIVE INVESTMENT SCHEMES:

16. DO YOU HAVE ANY COMMENTS ON THE USE OF COLLECTIVE INVESTMENT SCHEMES FOR CREDIT UNION INVESTMENTS?

> **Collective Investment Schemes**
> The 2016 Regulations provide that credit unions can invest in collective investment schemes comprised of permitted investment classes. However, analysis of existing credit union investment portfolios indicates limited use by credit unions of collective investment schemes. Based on data submitted by credit unions for December 2016, only c.3% of total investments are held in collective investment schemes.
>
> ***Source: Page 18, CP109***

The extract from CP109 suggest that CIS's are only used on a limited basis in Credit Unions. This is disingenuous in the extreme. We have on a number of occasions explored the option of using a CIS. However, this proved impossible as the permitted investment classes are so restrictive as to rule out the viability of such a scheme. The reason that they are not used is that current regulations have prevented their use.

17. ARE THERE ANY BARRIERS TO CREDIT UNIONS USING COLLECTIVE INVESTMENT SCHEMES IN THE EXISTING INVESTMENT REGULATORY FRAMEWORK?

Yes. The existing framework. There is no logic in using a CIS to buy a bank bond when a Credit Union can buy the bank bond directly. A CIS should be used to allow Credit Unions invest in a diversified professionally managed investment portfolio consisting of cash, bonds, equities and property.

TIMELINES:

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 disagree with the proposed changes at they will result in reduced income and increased risk.

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