Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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Consultation on Potential Changes to the Investment Framework for Credit Unions

Consultation Paper CP109

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Section 1: Introduction

The Central Bank of Ireland (the Central Bank) is publishing this consultation paper to consult on potential changes to the investment framework for credit unions.

On 1 January 2016 section 12 of the Credit Union and Co-operation with Overseas Regulators Act 2012 (the 2012 Act) was commenced which substituted a new section 43 in the Credit Union Act, 1997 (the 1997 Act) and provided regulation making powers to the Central Bank in relation to investments. The Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (the 2016 Regulations) also commenced on 1 January 2016 with Part 5 of the 2016 Regulations setting out investment regulations for credit unions.

Section 43 (1) of the 1997 Act requires that a credit union shall manage its investments to ensure that those investments do not (taking account of the nature, scale, complexity and risk profile of the credit union) involve undue risk to members' savings and, for that purpose, before making an investment a credit union shall assess the potential impact on the credit union, including the impact on the liquidity and financial position of the credit union. Under section 43(2) of the 1997 Act, the Central Bank may prescribe investments in which a credit union may invest its surplus funds.

Under the existing regulations, credit unions are permitted to invest in a range of specified investment classes which includes government securities, bank deposits, bank bonds and collective investment schemes made up of these instruments. Investments in these classes of investments are subject to specified maturity and concentration limits which are set out in the regulations.

The framework set out in the existing investments regulations is largely based on the previous framework as set out in the 2006 Guidance Note on Investments by Credit Unions. Feedback received on CP88 "Consultation on Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act" indicated that some respondents were of the view that credit unions should be permitted to invest in additional classes of investments including bonds of state bodies, social housing and state projects. In the Feedback Statement on CP88, the Central Bank noted that the power to make regulations in relation to investments in projects of a public nature is specifically referenced in the regulation making powers provided for under section 43 of the 1997 Act and that therefore such investments could be facilitated by future regulations, where appropriate, when there were specific proposals available. Additionally, the 2016 Regulations make reference to the fact that the Central Bank may prescribe, in accordance with section 43 of the 1997 Act, further classes of investments for credit unions which may include investments in projects of a public nature. The regulations state that investments in projects of a public nature include, but are not limited to, investments in social housing projects.

In order to ensure that the investment regulations remain appropriate for the credit union sector, the Central Bank undertook to review the investment regulations in 2017 to consider whether it is appropriate and prudent, at this stage, to facilitate investment by credit unions in other classes of investments. This review has taken account of the existing makeup of sector investments; proposals being brought forward by the sector;

and changes to the investment environment arising from the EU Bank Recovery and Resolution Directive (BRRD).

The review was undertaken in the context of:

- the Central Bank's statutory mandate to regulate and supervise credit unions with a view to ensuring the protection by each credit union of the funds of its members and the maintenance of the financial stability and well-being of credit unions generally;
- the objects of credit unions set out in the 1997 Act; and
- the legislative requirement, set out in section 43 of the 1997 Act, for credit unions to ensure investments do not involve undue risk to members' savings.

This informs the appropriate level of investment risk that credit unions should be permitted to take and should inform credit unions in setting their own investment risk appetites. The Central Bank is of the view that any changes to the investment framework for credit unions should reflect the fact that it is the savings of credit union members (which can be withdrawn on demand) that will be invested by credit unions and that the risk profile of credit union investment portfolios should reflect this. This will necessarily impact on the level of return that appropriate investment portfolios can generate.

Following this review, the Central Bank is now consulting on potential changes to the investment framework for credit unions. This consultation paper sets out potential changes to the investment framework for credit unions, along with a Regulatory Impact Analysis (RIA), and seeks views from credit unions and other sector stakeholders on the potential changes outlined, together with feedback as to whether there are additional investment classes appropriate for credit unions taking account of the appropriate risk profile for such investments.

The Central Bank will consider the feedback received as part of this consultation prior to finalising changes to the investment framework for credit unions and publishing a statutory instrument amending the investment regulations for credit unions. In addition, as part of the post implementation review the Central Bank will perform and publish an analysis on credit union sector investments two years post commencement of new investment regulations for credit unions to assess and analyse the actual impact which the regulations have had.

The consultation paper is structured as follows:

- Section 2 sets out the purpose of this consultation;
- Section 3 provides an overview of the review undertaken;
- Section 4 provides an overview of the potential changes to the investment framework that the Central Bank is considering following its review;
- Section 5 provides an overview of the RIA undertaken;
- Section 6 outlines next steps in relation to this consultation;
- Section 7 summarises the areas where the Central Bank is seeking views;
- Section 8 sets out how to make submissions to the Central Bank;
- Appendix A sets out the existing investment regulatory framework for credit unions; and
- Appendix B contains the full RIA.

Section 2: Purpose of this consultation

Following a review of the investment regulations for credit unions introduced on 1 January 2016, the Central Bank is considering a number of potential changes to the investment framework for credit unions.

Views are sought in this consultation paper on:

- Potential changes to the investment framework for credit unions – section 4 of this consultation paper sets out the potential changes to the framework and asks for views on these.

The specific questions credit unions and stakeholders are asked to respond to are set out throughout section 4. These questions are summarised in section 7.

Detail on the RIA, that assesses the likely impact of potential changes to the investment framework, is set out in section 5. The full RIA is contained in Appendix B. Credit unions and other sector stakeholders may also wish to provide additional information or analysis they may have on the likely impact of the potential changes to the investment framework.

Section 3: Review

3.1 Background

Under the existing regulatory framework, credit unions are permitted to invest in a range of specified investment classes which includes government securities, bank deposits, bank bonds and collective investment schemes made up of these instruments. Investments in these classes of investments are subject to specified maturity and concentration limits. Appendix A sets out existing investment requirements for credit unions contained in the 1997 Act and the 2016 Regulations.

In order to ensure that the investment regulations remain appropriate for the credit union sector, the Central Bank undertook to review the investment framework in 2017 to consider whether it is appropriate and prudent, at this stage, to facilitate investment by credit unions in other classes of investments. This review has taken account of a number of factors including:

- the Central Bank's statutory mandate to regulate and supervise credit unions with a view to ensuring the protection by each credit union of the funds of its members and the maintenance of the financial stability and well-being of credit unions generally;
- the objects of credit unions set out in the 1997 Act;
- the legislative requirement, set out in section 43 of the 1997 Act, for credit unions to ensure investments do not involve undue risk to members' savings;
- the existing makeup of sector investments (including observed trends over the past five years);
- proposals being brought forward by the sector; and
- changes to the investment environment arising from BRRD.

3.2 Current Make-up of Sector Investments – Trends over past five years

As part of the review of investment regulations we considered the existing make-up of credit union balance sheets and specific trends observed over the past five years from December 2011 to December 2016. Analysis of this data identified a number of key trends:

- **Growth in sector assets** – sector assets have increased by €2.3bn since 2011. At the end of 2011, total sector assets were €13.8bn, with total loans of €5.5bn and total investments of €8bn. At the end of 2016, total sector assets were €16.1bn, with total loans of €4.1bn and total investments of €11.4bn.
- **Decline in the sector loan to asset ratio** – the sector's average loan to asset ratio has declined from 41% at the end of 2011 to 27% in Dec 2016, which has resulted in an increase in the sector's average investment to asset ratio, which currently stands at close to 70% (as these are sector averages the profile of individual credit unions may not reflect sector wide trends in all cases);
- **Increasing exposure to accounts in authorised credit institutions and bank bonds** – the majority of credit union investments are held in accounts in authorised credit institutions (73%) or bank bonds (18%) with the proportion of investments held in these classes increasing over the past five years;
- **Falling investment income** – investment income has been contracting annually since 2012. Investment income in 2012 was c.€299 million and reduced to c.€174 million in 2016;

- **Increasing maturity profile of investments** – the maturity profile of sector investments has been increasing, with the proportion of total investments maturing after one year up from 27% in 2011 to 55% in 2016;
- **Counterparty exposures** – credit unions have continued to invest in a wide range of counterparties, however a large proportion of their overall investments are exposed to a small number of counterparties with nearly 70% of total investments held by credit unions held with only five counterparties.

Further detail on this analysis is set out in section 2 of the RIA in Appendix B.

3.3 Current Investment Environment

3.3.1 Interest Rate Environment

As a result of the continued level of surplus funds available to credit unions arising from the savings of members and the low loan to asset ratio, investments represent a significant portion of assets in the credit union sector and many credit unions have become heavily reliant on investment portfolios to generate sufficient returns. Against this background, the current low interest rate environment has impacted on the capacity of credit unions to generate income from investment portfolios.

However, irrespective of current yield levels, investment regulations must reflect appropriate levels of investment risk for credit unions consistent with the requirement under section 43 of the 1997 Act. While this will limit the potential to generate significant income from credit union investment portfolios, the Central Bank is of the view that this is appropriate as the overriding consideration in setting investment regulations must be our statutory mandate to regulate and supervise credit unions with a view to ensuring the protection by credit unions of the funds of its members' and the maintenance of the financial stability and well-being of credit unions generally.

3.3.2 Impact of the BRRD for Credit Union Investments

Changes arising from the BRRD impact on the risk profile of certain investment instruments which credit unions invest in. Credit union accounts in authorised credit institutions and bank bonds may be bailed in should a resolution occur, thus it is important that credit unions understand the risk implications of their investment options and ensure that investment instruments continue to be within the risk appetite of the credit union taking account of these changes.

BRRD Changes

The BRRD establishes an EU resolution framework with tools for dealing with failing banks and in-scope investment firms[1]. The BRRD was transposed into Irish legislation on 15 July 2015.

A key goal of resolution is to ensure that moral hazard is addressed, through minimising the use of taxpayers' money to support failing banks. A key element of the resolution framework is the bail-in tool. This tool ensures that creditors and shareholders appropriately bear losses in a resolution event by writing down and converting equity in-scope liabilities, thus removing reliance on public sector recapitalisation. All liabilities

[1] Further information on BRRD is available at the following link: http://europa.eu/rapid/press-release_MEMO-14-297_en.htm

of an institution are subject to bail-in unless excluded. Excluded liabilities include covered deposits and secured liabilities. Credit union accounts in authorised credit institutions and bank bonds are not excluded and as the Bank Recovery and Resolution Regulations[2] are currently in force, may be bailed in should the resolution tool be applied to an institution.

To ensure that firms have sufficient capacity to absorb losses, they need to adhere to a Minimum Requirement for own funds and Eligible Liabilities (MREL). MREL requires an institution to maintain liabilities that may qualify as MREL and include the following once criteria are met:

1. Equity;
2. Tier 1 capital;
3. Tier 2 capital;
4. Subordinated debt;
5. Senior unsecured debt; and
6. Non-SME / non retail deposits with remaining maturity of at least one year.

A key principle of the EU resolution framework is the "no creditor worse off" or "NCWO" principle. It stipulates that no creditor should be worse off in resolution than they would have been under normal insolvency proceedings. To ensure this principle is not breached, resolution authorities can require subordination of liabilities that are eligible for MREL and this can be achieved through various approaches:

a) **Statutory subordination**: by statute, all relevant debt issued by firms is legally subordinated to other liabilities issued by that institution;
b) **Structural subordination**: issuance of instruments from a resolution entity (typically a holding company (HoldCo)) which sits above operating subsidiaries. In a resolution, the material losses of the operating entity will be up streamed to the HoldCo; or
c) **Contractual subordination**: subordination to other liabilities is reflected in the contractual terms of the individual investment instrument.

MREL is set by the resolution authority and complements existing capital requirements set by the supervisory authority. MREL is a subset of total eligible liabilities and therefore liabilities excluded from MREL are not necessarily excluded from bail-in.

As noted above, the bail-in tool can currently be applied to in-scope liabilities. EU banks are issuing subordinated debt using the various approaches at present. Irish banks may issue subordinated debt to meet MREL in due course, however outstanding issuances and any issuance of new senior debt in the interim remains subject to bail-in and may be eligible for MREL.

It is important that credit unions understand the risk implications arising from the BRRD for their investment options and ensure that the instruments they invest in continue to be within their risk appetite. The Central Bank is of the view that it is appropriate that credit unions would **not** be permitted to invest in subordinated debt instruments that are eligible for MREL, given their risk profile and the potential implications for credit unions should the institution that issued the instrument enter into resolution.

2 Statutory Instrument 289 of 2015.

Currently, the 2016 Regulations define a bank bond as follows – *"bank bonds" means senior bonds issued by a credit institution and traded on a regulated market where the capital amount invested is guaranteed by the issuer.*

Under the 2016 Regulations, *"credit institution" means a person authorised as same pursuant to Directive 2013/36/EU*.

We have reviewed the definition of a bank bond in the context of the forms of subordination outlined above:

- **Statutory Subordination** – the Central Bank is of the view that a bond issued by a credit institution that is subordinated under the applicable law to any unsecured creditor of the credit institution, should not be considered to be a senior bond for the purposes of the definition of "bank bonds" in the 2016 Regulations.
- **Structural subordination** – as a holding company would not fall within the definition of a credit institution, credit unions are not permitted to invest in debt issued by a holding company.
- **Contractual subordination** – credit unions should not be permitted to invest in bonds that contain a contractual provision that subordinates them, now or at some point in the future, to other unsecured liabilities of the institution.

The Central Bank is proposing amending the definition of bank bonds in the 2016 Regulations to clarify that bonds that are subordinated to any senior bonds issued by a credit institution do not fall within the definition of "bank bonds" set out in the regulations. Credit unions will need to ensure that they confirm that instruments are not subordinated debt instruments which are eligible for MREL prior to making an investment to ensure that they remain in compliance with investment regulations.

The Central Bank recognises the impact that this may have on the available investment options for credit unions as issuance of bonds by credit institutions may not fall within the proposed amended definition of bank bonds. It is further recognised that this may impact on the ability of credit unions to achieve appropriate levels of diversification in investment portfolios and this has been considered as part of the overall review of investment regulations.

Conclusion

Notwithstanding the current investment environment for credit unions including the current low level of interest rates, the Central Bank's overriding consideration, in considering changes to the investment framework for credit unions, remains our statutory mandate and the legislative requirement under section 43 of the 1997 Act for credit unions to ensure investments do not involve undue risk to members' savings. The risk return trade-off means that potential investment returns will generally only rise with an increase in investment risk. Credit union investment portfolios should reflect the objects of credit unions and the fact that it is members' savings that are being invested by credit unions. The primary objects and purpose of a credit union remains the promotion of thrift among its members by the accumulation of their savings and the creation of sources of credit for their mutual benefit at fair and reasonable interest rates.

This informs the appropriate level of investment risk that credit unions should be permitted to take and should inform credit unions in setting their own investment risk appetites. This will necessarily impact on the level of return that appropriate investment portfolios can generate.

Consideration also needs to be given to the potential impacts that changes to the current investment framework may have on the structure of credit union balance sheets. Given the on-demand nature of credit union funding (i.e. savings from members), any proposal that has the potential to lengthen the maturity of assets needs to be considered in a broader asset and liability management (ALM) context. Credit unions should be cognisant of their obligation under section 85A(2) of the 1997 Act to ensure that they at all times keep a proportion of their total assets in liquid form so as to enable the credit union to meet its obligations as they arise and that the proportion of assets kept in liquid form must take into account the nature, scale and complexity of the credit union and the composition and maturity of its assets and liabilities.

There is a need for credit unions to fully understand the risks associated with all investments and ensure that they are in line with the risk appetite of the credit union. Credit unions are required to develop, implement, document and maintain a risk management system with such governance arrangements and systems and controls to allow it identify, assess, measure, monitor, report and manage the risks which it is, or might reasonably be, exposed to. In addition, credit unions are required to implement systems and controls to manage and mitigate the risks identified by the risk management system.

Having considered:

- the existing make-up of investments and sector trends;
- the specific characteristics of the credit union sector;
- the current investment environment; and
- proposals brought forward from sector stakeholders around the allocation of credit union funds for social housing investment,

the Central Bank considers that it is appropriate to add additional investment classes for credit unions to help to ensure that appropriate levels of diversification can be achieved in credit union investment portfolios. The Central Bank notes the level of concentration in existing credit union portfolios by both asset class and counterparty and the tendency for many credit unions not to fully utilise all existing available investment classes and limits to ensure portfolio diversification.

The Central Bank has identified a number of potential additional investment classes and has also calibrated suggested limits for these investment classes with a view to containing risk levels within appropriate parameters – these potential investment classes and associated limits are detailed in the following section of this consultation paper. The Central Bank is seeking views on the appropriateness of these investment classes for credit unions.

The Central Bank commits to performing and publishing analysis of credit union sector investments two years post commencement of any amendments to the investment framework for credit unions to assess and analyse the actual impact which such amendments have had.

Section 4: Potential Additional Investment Classes

As set out above, in considering additional investment classes for credit unions the Central Bank has been informed by our statutory mandate and the overriding requirement set out in section 43 of the 1997 Act. The Central Bank is also cognisant that the core function of a credit union is the provision of savings and loans to members.

This narrows the range of investments that would be considered appropriate for credit unions and, in considering potential additional investment classes for credit unions, the Central Bank has focused on the lower end of the risk spectrum concentrating on fixed income investments and investments with particular characteristics that will help to ensure appropriate levels of investment risk for credit unions.

The Central Bank is considering the following potential additional investment classes for credit unions:

- Bonds issued by Supranational Entities;
- Corporate Bonds; and
- Investments in Tier 3 Approved Housing Bodies[3] (AHBs).

The addition of these investment classes would be accompanied by the introduction of specified credit quality, maturity and concentration limits. This would help to ensure that appropriate levels of diversification can be achieved in credit union investment portfolios. The existing requirement that any investment made by a credit union must be euro denominated would apply to the potential classes of investments.

The Central Bank welcomes views on the appropriateness of these potential investment classes for credit unions and whether there may be additional investment classes which would fit within the appropriate risk profile for credit union investments.

In light of the potential additional investment classes for credit unions, the Central Bank is also considering an amendment to the counterparty exposure limit for credit unions.

Notwithstanding the potential introduction of additional investment classes, the obligation remains for each credit union to ensure that investments undertaken are in line with their risk appetite and that they have sufficient governance and risk management controls in place for investments.

The Central Bank is seeking views on the following:

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.
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?
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,

[3] The regulatory code applied to AHBs divides AHBs into three tiers – Tier 3 refers to larger AHBs.

please outline the investment classes and why such investment classes are considered appropriate for credit unions.

4.1 Bonds issued by Supranational Entities

Credit unions are currently permitted to invest in Irish and EEA state securities. The Central Bank is considering permitting credit unions to invest in bonds issued by supranational issuers (entities formed by two or more central governments with the purpose of promoting economic development for the member countries), subject to certain limits. Examples of Supranational entities that currently issue euro denominated bonds include the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD). This would provide credit unions with additional opportunities to diversify counterparty exposure.

Limits

Minimum Credit Rating: We are of the view that it would be appropriate that credit unions would be permitted to invest in Supranational bonds with a minimum rating of no less than A or equivalent applied by at least two recognised rating agencies. The Central Bank would require that where a bond held in a supranational entity no longer met the minimum rating requirement, the credit union would be required to divest of the bond as soon as possible in order to ensure compliance with requirements and ultimately to ensure appropriate management of the risks of its investment portfolio.

Maturity Limit: The Central Bank considers that it would be appropriate that investments in Supranational bonds would fall within the existing maximum maturity limit of 10 years.

Concentration Limit: The Central Bank is of the view that it would be appropriate to introduce a concentration limit for all credit unions in relation to investments in supranational bonds. Under such a limit, credit unions would be permitted to invest in supranational bonds provided the investment did not exceed 50% of the credit union's regulatory reserve.

Impact analysis of these limits is set out in the RIA in Appendix B.

The Central Bank is seeking views on the following:

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?
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.

4.2 Corporate Bonds

Credit unions are currently permitted to invest in bank bonds but not permitted to invest in bonds issued by corporates. A number of submissions to the Central Bank on previous consultations have suggested that credit unions should be permitted to invest in corporate bonds based on the diversification potential that this would provide.

While we acknowledge some of the potential diversification benefits of investing in corporate bonds, the Central Bank is of the view that investing in corporate bonds represents a significant change for credit unions compared to existing investments and requires a degree of expertise that credit unions would need to develop. This may prompt reliance on investment advisers. However, where credit unions are dealing with an investment adviser, they need to ensure that the advisers have adequately explained why an investment is suitable for the credit union and that they understand the risk. It is important that credit unions understand they cannot outsource the judgement regarding investment risk to an external party such as an investment adviser and that the credit union remains responsible for both the investment decisions and the funds of its members. It is vital that any credit union that undertakes investments in corporate bonds fully understands the specific characteristics of the investment and all associated risks.

The Central Bank is considering permitting credit unions to invest in corporate bonds subject to limits such as those set out below. As with existing classes of investments, under this proposal, credit unions would be permitted to gain exposure to corporate bonds through direct holdings of individual corporate bonds or through collective investment schemes, provided the underlying investments in the collective investment scheme fall within the limits specified in the regulations.

Limits

Minimum Credit Rating: In recognition of the risks highlighted above, the Central Bank is of the view that it would be appropriate that credit unions would be permitted to invest in corporate bonds with a minimum rating of no less than A or equivalent applied by at least two recognised rating agencies. The Central Bank would require that where a corporate bond held no longer meets the minimum rating requirement, the credit union would be required to divest of the bond as soon as possible in order to ensure compliance with requirements and ultimately to ensure appropriate management of the risk of its investment portfolio.

Maturity Limit: The Central Bank is of the view that it would be appropriate that investments in corporate bonds would fall within the existing maximum maturity limit of 10 years.

Concentration Limit: We are of the view that it would be appropriate to introduce a concentration limit for all credit unions in relation to investments in corporate bonds. Under such a limit, credit unions would be permitted to invest in corporate bonds provided the investment did not exceed 25% of the credit union’s regulatory reserve.

Impact analysis of these limits is set out in the RIA in Appendix B.

The Central Bank is seeking views on the following:

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?
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.

4.3 Investments in Approved Housing Bodies

The sector has engaged with the Central Bank in relation to proposals for credit unions to provide funding to AHBs for the provision of social housing. Common bond restrictions limit the potential for credit unions to lend to AHBs, either directly or on a syndicated basis, and as a result proposals have focused on investment-based funding. These proposals are based around the establishment of a collective investment vehicle, which would facilitate the provision of credit union funding to AHBs by way of investment.

More generally in the context of social housing investment, the Government has been actively exploring potential mechanisms that would facilitate the provision of social and affordable rental housing, including a proposal to establish a Special Purpose Vehicle to acquire properties for onward leasing to local authorities and AHBs[4].

Approved Housing Bodies – Background Information

Social housing in Ireland has been traditionally provided through local authorities building or purchasing units, with AHBs providing a small proportion of social housing based on capital grants from central government. However, the shift away from direct capital funding by government towards the use of loan finance has increased the role for AHBs in the provision of social housing.

AHBs directly provide and manage rented social housing. They are privately operated, non-profit organisations focused solely on providing social housing. There are approximately 520 AHBs in Ireland with a portfolio of over 26,000 units[5].

The Social Housing Current Expenditure Programme (SCHEP) was extended in November 2009 to allow for the direct provision of dwellings for social housing purposes by AHBs. This can be achieved in two ways:

- The AHB can lease units from a private owner / developer and make them available to persons assessed as being in need of social housing support; or
- The AHB can purchase / construct units using private / government finance, which are then made available to meet housing needs.

In both cases, where proposals are approved, the housing authority enters into a payment and availability (P&A) agreement directly with the AHB. The Department of Housing, Planning, Community and Local Government (DECLG), via the housing authority, pays the AHB the availability payment, with the level of payment based on local market rent[6].

In addition to funds made available under P&A agreements the DECLG also has a Capital Advance Leasing Facility (CALF) available to support AHBs in acquisition and construction projects using private finance. Under this facility the DECLG provide financial support in the form of a capital advance to the AHB. This is in the form of an unsecured bullet loan, repayable at maturity, made available by the DECLG to AHBs for up to 30% of required financing[6].

4 http://rebuildingireland.ie/Rebuilding%20Ireland_Action%20Plan.pdf
5 https://www.housingagency.ie/Regulation.aspx
6 http://www.icsh.ie/sites/default/files/attach/icsh-news/1035/calf_guidance_april_2016.pdf

Current Funding

AHB's currently access funding from the Housing Finance Agency (HFA) subject to satisfying a number of criteria. The HFA is a state-owned company which provides loan finance to local authorities and voluntary housing bodies for housing and related purposes. The HFA raises its funds on the domestic and international capital markets, including funding provided by the European Investment Bank (EIB). The HFA has indicated that it adds a small margin onto its cost of funds to cover its administration costs. In the current interest rate environment, this allows the HFA to provide attractive rates on long term funding products for AHBs[7]. In their 2020 Strategy document, the HFA indicated that it is developing business with the AHB sector and will grow its loan portfolio by €680m up to 2020[8].

Regulation of AHBs

AHBs must gain approval status from the government under section 6 of the Housing (Miscellaneous Provisions) Act, 1992 in order to enter the sector. The Regulations Team within the Housing Agency (a government agency) currently have responsibility for the regulation of AHBs. Regulation of the sector is currently based on a Voluntary Regulation Code which was introduced in 2011. The regulatory code divides AHBs into three tiers – Tier 1 refers to smaller AHBs, Tier 2 to medium sized AHBs and Tier 3 refers to larger AHBs[9]. The Government's Housing Strategy has committed to introducing statutory based regulation for AHBs.

Identified Potential Risks

Having considered proposals brought forward by the sector for investing in AHBs and undertaken research on AHBs and the funding of social housing the Central Bank has identified a number of potential risks associated with credit unions investing in AHBs.

Development Risk

Investment in AHBs would represent a significant new venture for credit unions and with any new business development, there will always be a degree of "development" risk. This may prompt reliance on external advisers including investment and legal advisers and credit unions would need to carefully consider the potential impact on their risk adjusted return and all other aspects of such investments before becoming involved in a new area of investment.

Investments in AHBs could be facilitated through a number of structures including collective investment schemes for professional investors. The Market in Financial Instruments Directive (MiFID) imposes certain obligations on investment firms and credit institutions when providing investment services to their clients. MiFID classifies clients into two categories, namely Retail Clients and Professional Clients, with a higher duty of care owing to Retail Clients. While credit unions are automatically categorised as Professional Clients under MiFID they may opt to be treated as Retail Clients. The Central Bank reminds credit unions of the need to give careful consideration as to whether they undertake investments which would see them designated as Professional

7 http://www.hfa.ie/hfa/Live/Release/WebSite/HomePage/lending2approved.html

8 http://www.hfa.ie/hfa/Live/Release/WebSite/HomePage/documents/HFA%20Strategy%20Statement.pdf

9 Tier 1: small AHBs with 0 – 50 units without development plans for more units / Tier 2: AHBs with between 50 and 300 units and / or with development plans in place to provide more units / Tier 3: All AHBs with more than 300 Units.

Clients and the resulting implications which this may have for how they would be treated under MiFID by their investment advisors. Credit unions are also reminded that with effect from 3 January 2018, MiFID is being replaced by MiFID II[10].

As with all investments, it is important that credit unions understand that they cannot outsource the judgement regarding investment risk to an external party such as an investment adviser and that the credit union remains responsible for both the investment decisions and the protection of the funds of its members. It is vital that, if credit unions propose investing in AHBs they fully understand the specific characteristics of the underlying investment, the investment vehicle and all associated risks.

Funding from credit unions would also represent a new source of funding for AHBs which may result in certain risks arising as new processes, policies and procedures are developed and implemented by credit unions and AHBs.

Balance Sheet Risks

Investment in AHBs would also involve specific balance sheet risks for credit unions including the risks associated with longer term investments with potentially no liquidity.

Credit unions would need to take account of maturity considerations and the balance sheet impact of undertaking investments in AHBs which, by their nature, would be significantly longer term than existing investments and could result in an increase in the existing maturity mismatch on the credit union's balance sheet (analysis on the potential impact of such investments is set out in the RIA in Appendix B). However, the current high level of liquidity in credit unions may help to manage some of the liquidity risk arising from this balance sheet mismatch. More generally, total members' savings in credit unions remained stable during the financial crisis.

Consideration would also need to be given to the interplay between a possible move to longer term lending and longer maturity investments, which would exacerbate the existing mismatch between the maturity profile of the sector's funding and assets. As previously flagged by the Central Bank, if credit unions want to significantly shift the maturity profile of their assets, they will need to consider how they can extend their funding profile, particularly if it requires longer term tie-ups of funds belonging to ageing members.

The Central Bank acknowledges that as credit unions look to further develop their business models and potentially increase their exposure to longer term lending, maturity limits for the balance sheet and associated funding and liquidity requirements will need to be reviewed and amended through regulations, as appropriate.

Demand for Funding

The timelines and funding needs of AHBs will also impact significantly on the ability of credit unions to provide funding for social housing via AHBs, while availability of alternative competitively priced funding may limit the potential for such investments to enhance credit union investment returns.

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10 https://www.esma.europa.eu/policy-rules/mifid-ii-and-mifir

Counterparty Risk
Regulation of AHBs is currently based on a Voluntary Regulation Code and a statutory regulatory framework is being developed for AHBs. Government support provided to AHBs via CALF and P&A agreements provides a degree of security to AHBs around their income flow. However, credit unions' counterparty exposure would be to individual AHBs or groups of AHBs and accordingly credit unions would also be dependent on the effective governance and management arrangements in place in individual AHBs. As a result, it would be important that credit unions could satisfy themselves that any AHBs they provide funding to are appropriately managed.

It is vital that any credit union considering undertaking investment in AHBs would be fully aware of the specific characteristics of the investment and all associated risks.

Central Bank View
The Central Bank is considering if it would be appropriate to provide an investment class to permit credit unions to invest in AHBs.

Having identified the potential risks and risk mitigants outlined above, the Central Bank is of the view, that in the context of potentially permitting credit unions to invest in AHBs, specific limits and requirements would need to be applied to such investments. The sections below set out the limits and requirements that the Central Bank would consider applying to credit union investments in AHBs.

The Central Bank is seeking views on the following:

8. Do you think it is appropriate for credit unions to undertake investments in AHBs? If so, please provide a rationale.
9. What would the most appropriate structure for investments in AHBs be e.g. investment vehicle?
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?
11. How can the ALM issues associated with such investments be addressed by credit unions?

Limits
Type of AHB: The Central Bank is of the view that it would be appropriate to limit investment to Tier 3 AHBs only, in recognition of the higher level of oversight that these AHBs are subject to from the Housing Agency Regulator including the more onerous requirements to which they are subject under the Voluntary Regulation Code.

Concentration Limit: In light of the risks identified above the Central Bank is of the view that it would be appropriate to introduce specific concentration limits for any investments in AHBs. These could be applied on a tiered basis to reflect the varying degrees of capacity and capability across the sector.

Concentration limits for investment in AHBs would have to be calibrated to take account of the longer term maturity of such an investment class and the existing mismatch between the maturity profile of credit unions' funding and assets. The Central Bank is of the view that given the current ALM framework for credit unions this would necessitate a relatively low concentration limit to avoid significantly exacerbating the existing mismatch between the maturity profile of the sector's funding and assets.

Analysis has been performed on illustrative concentration limits to assess the likely impact that such limits would have on the investment portfolios of credit unions – this is set out in the RIA in Appendix B.

Maturity Limit: Currently all investments are subject to a maturity limit of 10 years. Taking account of the nature of social housing projects and the likely duration for such investments, the Central Bank recognises that if investments in AHBs were to be permitted that this would require a longer maturity limit for such investments. The Central Bank, taking account of the existing mismatch between the maturity profile of the sector's funding and assets and the likely concentration limit that would apply to such investments considers that a specific maturity limit for investments in AHBs of 25 years would be potentially appropriate.

The Central Bank is seeking views on the following:

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[11]. 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?
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?

4.4 Other Considerations

In addition to considering 3 potential additional investment classes, we are also considering one other change to the investment framework in relation to counterparty limits and seeking feedback in relation to the operation of the existing investment class of collective investment schemes.

Counterparty Limit

The 2016 Regulations currently place a maximum exposure limit to an individual counterparty of 25% of total investments. As set out in the analysis in section 3.2 above, currently 70% of total investments held by credit unions are held with five counterparties. In light of the addition of three potential additional investment classes for credit unions, the Central Bank is proposing to amend the existing 25% counterparty limit set out in the 2016 Regulations to 20%. The Central Bank is proposing a transitional arrangement of 12 months post commencement of the amended investment regulations to facilitate credit unions in becoming compliant with this reduced counterparty exposure limit. As set out above the Central Bank notes the level of concentration in existing credit union portfolios and the tendency for credit unions not to use all existing available investment options to ensure appropriate levels of diversification in portfolios.

[11] The Central Bank acknowledges that sector averages may not reflect the profile of individual credit unions in all cases.

Impact analysis on this proposal is set out in the RIA in Appendix B.

The Central Bank is seeking views on the following:

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

The Central Bank is seeking views on the following:

16. Do you have any comments on the use of collective investment schemes for credit union investments?
17. Are there any barriers to credit unions using collective investment schemes in the existing investment regulatory framework?

Section 5: Regulatory Impact Analysis

In accordance with the Consultation Protocol for Credit Unions, issued on 27 November 2012, the Central Bank has conducted a RIA to assess the impact of the potential additional investment classes set out in this consultation paper.

The full RIA is set out in Appendix B. Credit unions and other sector stakeholders may also wish to provide additional information or analysis they may have on the likely impact of the potential changes to the investment framework.

Section 6: Next Steps

The table below sets out proposed next steps and timelines for the introduction of potential changes to the investment framework for credit unions set out in this consultation paper.

Date	Step
11 May 2017	Consultation Paper on Potential Changes to the Investment Framework for Credit Unions published
28 June 2017	Consultation period closes
Q4 2017	Publish feedback statement and final regulations
Q4 2017	Commencement of final regulations

The final regulations will be informed by feedback received on this consultation paper.

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.

Section 7: Summary of areas where the Central Bank is seeking views

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.
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?
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.

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?
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.

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?
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.

Investments in AHBs:

8. Do you think it is appropriate for credit unions to undertake investments in AHBs? If so, please provide a rationale.
9. What would the most appropriate structure for investments in AHBs be e.g. investment vehicle?
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?
11. How can the ALM issues associated with such investments be addressed by 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[12]. 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?

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?

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

Collective Investment Schemes:

16. Do you have any comments on the use of collective investment schemes for credit union investments?
17. Are there any barriers to credit unions using collective investment schemes in the existing investment regulatory framework?

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.

12 The Central Bank acknowledges that sector averages may not reflect the profile of individual credit unions inall cases.

Section 8: Making submissions

Please make your submissions in writing, if possible electronically as a word document or a .pdf document by email, on or before Wednesday 28 June 2017.

When addressing the questions raised in this Consultation Paper, please use the relevant section heading to identify the section you are referring to and clearly set out the basis for your views.

The Central Bank intends to make all submissions available on the Central Bank website. Information deemed to be potentially libellous or defamatory will not be published. The Central Bank will accept no liability in respect of any information provided which is subsequently released, or in respect of any consequential damage suffered as a result.

Submissions should be marked "Consultation on Potential Changes to the Investment Framework for Credit Unions" and sent by email to rcuconsultation@centralbank.ie.

In the event that you are unable to send your response electronically, please forward it by post before Wednesday 28 June to:

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

Registry of Credit Unions

Appendix A: Existing Investment Regulatory Framework

Legislation

Section 43 of the Credit Union Act, 1997
(1) A credit union shall manage its investments to ensure that those investments do not (taking account of the nature, scale, complexity and risk profile of the credit union) involve undue risk to members' savings and, for that purpose, before making an investment a credit union shall assess the potential impact on the credit union, including the impact on the liquidity and financial position of the credit union. (2) A credit union may invest any of its funds, which are surplus to its operating requirements and are not immediately required for the purposes of the credit union, in any one or more of the following: *(a)* the shares of, or deposits with (other than deposits to which subsection (6) relates) or loans to, another credit union as the Bank may prescribe; *(b)* the shares of a society registered under the Industrial and Provident Societies Acts 1893 to 1978 as the Bank may prescribe; *(c)* such other investments as may be prescribed for that purpose by the Bank under subsection (3). (3) For the purposes of subsection (2)(*c*) the Bank may prescribe investments in which a credit union may invest its funds. In prescribing matters for the purposes of subsection (2) and having regard to the need to avoid undue risk to members' savings, the Bank may also prescribe other matters in relation to prescribed investments, including any of the following: *(a)* the classes of investments, including, where appropriate, any investment project of a public nature the credit union may invest in; *(b)* the quality of investments and quality of counterparties that the credit union may invest in; *(c)* the maximum, including percentage, amount (by reference to a credit union's surplus funds to which subsection (2) relates or otherwise) of a class of investments that may be invested in; *(d)* the term to maturity of a class of investments; *(e)* the currency of a class of investments; *(f)* limits for investment, whether by reference to maturity, currency, counterparty, sector, instrument or otherwise; *(g)* any other matters that the Bank may consider necessary in the circumstances. (4) The Bank may prescribe matters for the purposes of any distribution policy to be applied by a credit union in respect of investment income.

(5) In prescribing matters for the purposes of this section, the Bank shall have regard to the need to ensure that the requirements imposed by the regulations made by it are effective and proportionate having regard to the nature, scale and complexity of credit unions, or the category or categories of credit unions, to which the regulations will apply.

(6) In so far as any funds of a credit union that are surplus to its operating requirements—

(a) are not immediately required for the purposes of the credit union,

(b) are not invested in accordance with subsection (2), or

(c) are not kept in cash in the custody of officers of the credit union,

those funds shall be kept by the credit union on current account with a credit institution.

(7) Where any funds of a credit union are on current account with, or on loan to, an institution which ceases to be a credit institution, the credit union shall take all practicable steps to call in and realise the loan within the period of 3 months from the time when the institution so ceased or, if that is not possible, as soon after the end of that period as possible.

Investment Regulations

CREDIT UNION ACT 1997 (REGULATORY REQUIREMENTS) REGULATIONS 2016
(S.I. No. 1 of 2016)

(This section has not reproduced the entirety of Part 1 – please consult the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 for the full provision.)

PART 1
PRELIMINARY AND GENERAL

Interpretation

In these Regulations, unless the context otherwise requires:-

“accounts in credit institutions” means interest bearing deposit accounts (or instruments with similar characteristics) in a credit institution;

“bank bonds” means senior bonds issued by a credit institution and traded on a regulated market where the capital amount invested is guaranteed by the issuer;

“the Bank” means the Central Bank of Ireland;

“collective investment schemes” means units, interests or shares in open-ended retail collective investment schemes, other than property schemes, authorised by the Bank or by a competent authority of another EEA State;

“counterparty” means any person that a credit union has made investments with. Where a counterparty is a company, the definition also includes a related company;

“deposit protection account” means the amount a credit union must maintain under the Deposit Guarantee Scheme;

"EEA" means the European Economic Area;
"investment gain" means an increase in the value of an investment, made as provided for under section 43 of the Act, on the balance sheet of a credit union, other than income receivable;
"investment income" means income received or receivable from an investment made as provided for under section 43 of the Act;
"Irish and EEA State Securities" means transferable securities issued by the Irish State and other EEA States and traded on a regulated market;
"regulated market" means a multilateral system as defined in Article 4 of Directive 2004/39/EC;
"the Act" means the Credit Union Act, 1997;

PART 5
INVESTMENTS

Classes of Investments

25. (1) A credit union may only invest in euro denominated investments in the following:
   - (a) Irish and EEA State Securities;
   - (b) accounts in credit institutions;
   - (c) bank bonds;
   - (d) collective investment schemes;
   - (e) shares of and deposits with other credit unions;
   - (f) shares of a society registered under the Industrial and Provident Societies Act 1893 to 1978.

   (2) The Bank may prescribe from time to time, in accordance with section 43 of the Act, further classes of investments in which a credit union may invest its funds which may include investments in projects of a public nature. Investments in projects of a public nature include, but are not limited to, investments in social housing projects.

Counterparty Limits

26. A credit union shall not make an investment with a counterparty which, were that investment to be made, would cause the investments with that counterparty to exceed 25 per cent of the credit union's total value of investments.

Concentration Limits

27. (1) A credit union shall not make an investment in Irish and EEA State securities which would cause the investments in Irish and EEA State securities to exceed 70 per cent of the total value of the credit union's investments.

   (2) A credit union shall not make an investment in bank bonds which would cause the investments in bank bonds to exceed 70 per cent of the total value of the credit union's investments.

   (3) A credit union shall not make an investment in another credit union which would cause the investments in other credit unions to exceed 12.5 per cent of its regulatory reserve.

(4) A credit union shall not make an investment in the shares of a society registered under the Industrial and Provident Societies Acts 1893 to 1978 which would cause the investments in shares in societies registered under the Industrial and Provident Societies Acts 1893 to 1978 to exceed 12.5 per cent of the credit union's regulatory reserve.

Maturity Limits

28. (1) A credit union shall not make an investment which has a maturity date which exceeds 10 years from the date of the investment.
(2) A credit union shall not make an investment which would cause the credit union to have more than 30 per cent of its investments maturing after 7 years.
(3) A credit union shall not make an investment which would cause the credit union to have more than 50 per cent of its investments maturing after 5 years.

Collective Investment Schemes

29. A credit union may invest in collective investment schemes only where the underlying investments of the scheme are: –
(a) composed entirely of instruments specified in Regulation 25(1)(a), (b) and (c); and
(b) the making of such an investment would not cause a credit union to fail to comply with this Part.

Holding of Investments

30. A credit union shall ensure that any investments made remain in compliance with the investment requirements in this Part.

Investment Practices – Distribution of Investment Income/ Investment Gain

31. A credit union shall not distribute from its annual operating surplus investment income or an investment gain to members or transfer investment income or an investment gain to a reserve set aside to provide for dividends, unless the investment income or investment gain falls within the following:
(a) investment income or an investment gain received by the credit union at the balance sheet date;
(b) investment income that will be received by the credit union within 12 months of the balance sheet date.

Investment Practices – Concentration Risk

32. A credit union shall establish and maintain a written strategy having regard to section 43 of the Act to manage concentration risk which can result from dealing with a single counterparty or holding investments with similar characteristics like maturities and to ensure investments remain within the limits contained in these Regulations.

Transitional Arrangements

33. (1) Where, at the commencement of these Regulations, a credit union has investments made in accordance with or under the Act which exceed the requirements in this Part, the credit union shall (subject to paragraph (2)):

(a) reduce those investments in order to ensure compliance with this Part;

(i) as soon as possible without incurring a loss; and

(ii) in any event not later than the second anniversary of the commencement of these Regulations or such later date as the Bank may permit, and

(b) shall only make an investment where the making of such an investment would not cause the credit union to either fail to comply or exacerbate a failure to comply with any of the requirements in this Part.

(2) A credit union may hold to maturity all fixed term investments held by that credit union on the commencement of these Regulations.

Appendix B: Regulatory Impact Analysis

Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

May 2017

Regulatory Impact Analysis on Potential Changes to the Investment Framework for Credit Unions

Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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1. Introduction

Section 43 of the Credit Union Act, 1997 (the Act) provides regulation making powers to the Central Bank in relation to investments. The Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (the Regulations) commenced on 1 January 2016 with Part 5 of these regulations setting out investment classes and the associated concentration and maturity limits for credit unions.

Through its ongoing engagement with credit unions and credit union sector stakeholders, the Central Bank undertook to review the investment framework for credit unions to establish if there are any other classes of investments into which credit unions should be permitted to invest. As part of this process the Central Bank is carrying out a consultation on potential changes to the investment framework, **'Consultation on Potential Changes to the Investment Framework for Credit Unions- Consultation Paper 109'** (CP109).

The 'Consultation Protocol for Credit Unions', issued on 27 November 2012, states that a Regulatory Impact Analysis (RIA), which will contain an examination of the impacts of the new regulations and consideration of alternative options, will be carried out by the Central Bank, where practicable, when consulting on new regulations.

As part of the review of the investment framework for credit unions, the Central Bank undertook a RIA, set out below, to examine the impact of potential changes to the investment framework for credit unions.

The RIA is structured as follows:

- Section 2 sets out the policy context and objectives and provides an overview of the credit union sector;
- Section 3 outlines potential changes to the investment framework for credit unions;
- Section 4 analyses the costs, benefits and impacts of the potential changes to the investment framework;
- Section 5 provides detail on the consultation paper related to this RIA;
- Section 6 specifies the responsibilities for enforcing and ensuring compliance with the investment regulations for credit unions;
- Section 7 provides detail on a review of the investment framework which the Central Bank will perform to assess the actual impact which the potential changes have had, should they be introduced;
- Section 8 provides detail on the publication of the RIA and related consultation paper; and
- Appendix 1 provides detail on the assumptions used for analysis contained in section 4.4.4 of the RIA.

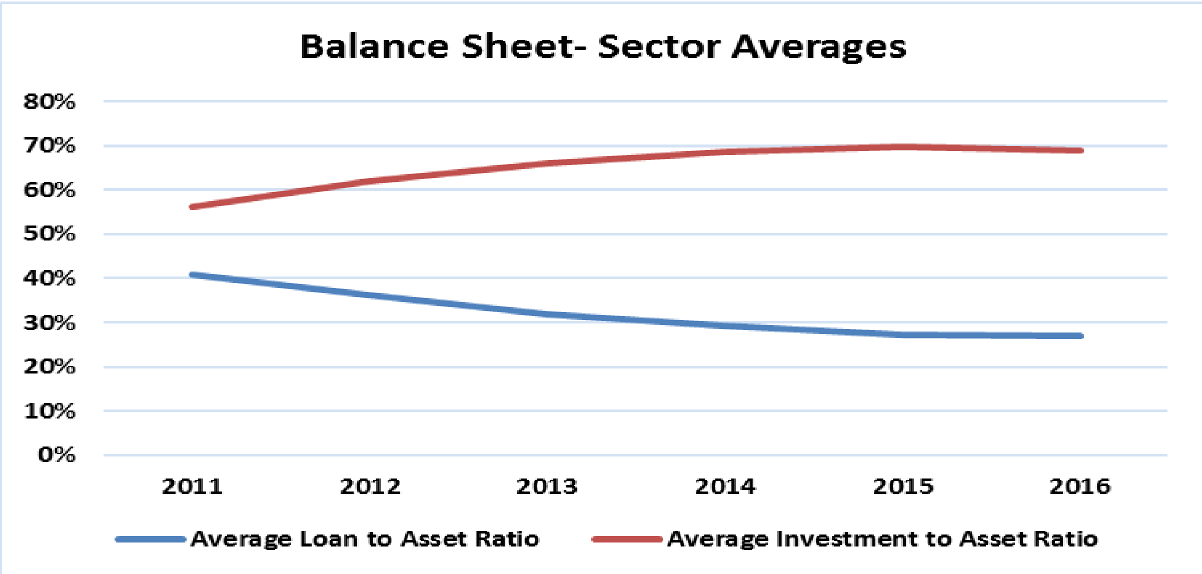
2. Policy context and objective

There are currently 280[1] actively trading credit unions with total members reported to be in the region of 3.3 million. Total assets in the credit union sector amount to €16.1 billion, of which €11.4 billion relates to investments, €4.1 billion represents loans to members and the balance is held in other assets including fixed assets. Total members' savings amount to €13.4 billion and total realised reserves amount to €2.6 billion[2].

2.1 Sector Assets Composition

Since 2011, while total assets of the sector have increased by €2.3 billion (17%), total lending has contracted by approximately 25% over the same period with the average sector loan to asset ratio declining from just 41% in 2011 to 27% in 2016. At the same time investments have been steadily increasing with the average sector investment to assets ratio standing at close to 70% at December 2016. This shift in sector balance sheet composition is illustrated in Chart 1.

Chart 1



Source: Prudential returns submitted by individual credit unions (December quarter returns)

2.2 Current Sector Investments

The Regulations prescribe the classes of investments into which credit unions may invest surplus funds. Chart 2 shows a breakdown of the sector investment portfolio by investment product from 2011 to 2016. As evidenced, the majority of credit union investments are currently held in accounts in authorised credit institutions (73%) and bank bonds (18%) and the proportion of investments held in both these products has been steadily increasing over the past five years. For all existing investment classes, credit unions are only permitted to invest in euro denominated investments.

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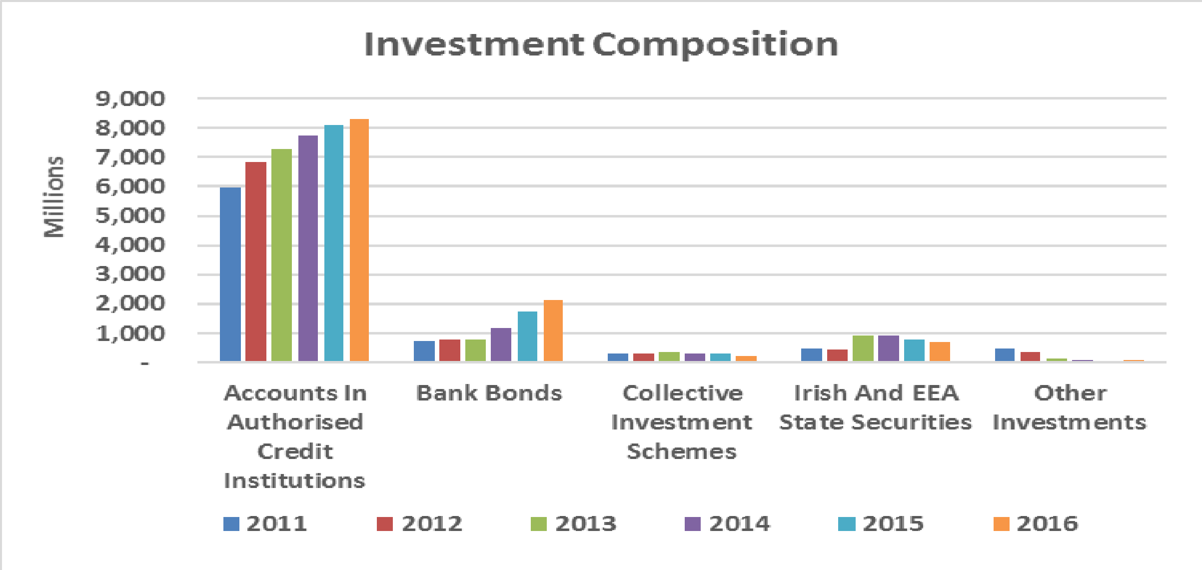
1 As at 10 May 2017.

2 As reported by credit unions on the Prudential Return for 31 December 2016.

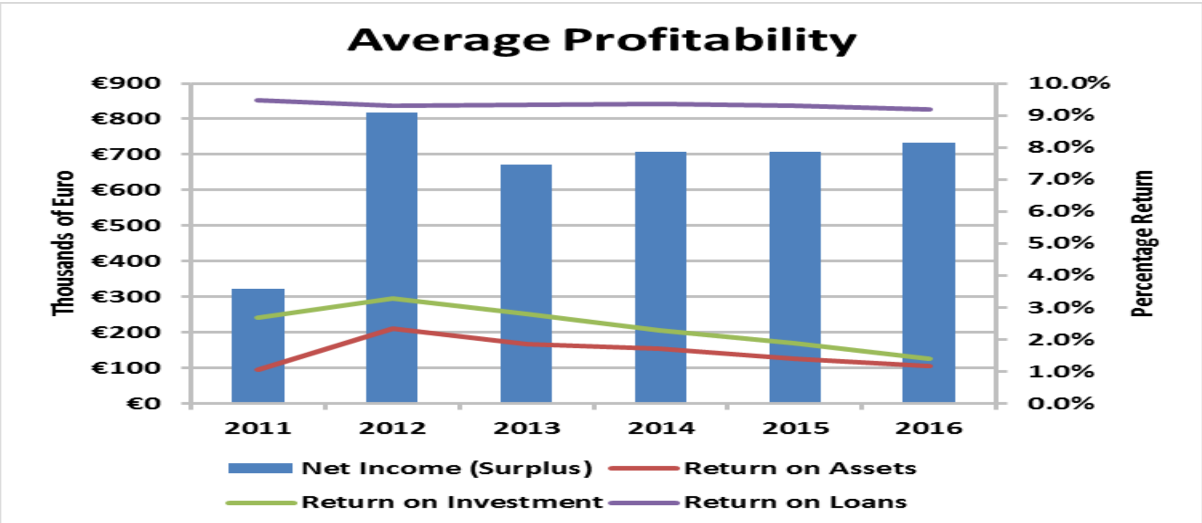
Chart 2



Source: Prudential returns submitted by individual credit unions (December quarter returns)

While the investment to assets ratio has increased significantly in recent years investment income has been contracting annually since 2012 driven by decreasing rates of return on investments. Investment income in 2012 was c.€299 million and reduced down to c.€174 million in 2016. The low interest rate environment is having an impact on credit union income and this effect will become more pronounced as longer term investments mature and the rate of return earned on re-investment is significantly reduced. The Central Bank is aware that in the current low interest rate environment certain credit institutions are charging credit unions for placing funds on deposit. Chart 3 depicts the downward trend that has been evidenced in return on investments and also on overall return on assets since 2012.

Chart 3



Source: Prudential returns submitted by individual credit unions (September quarter returns)

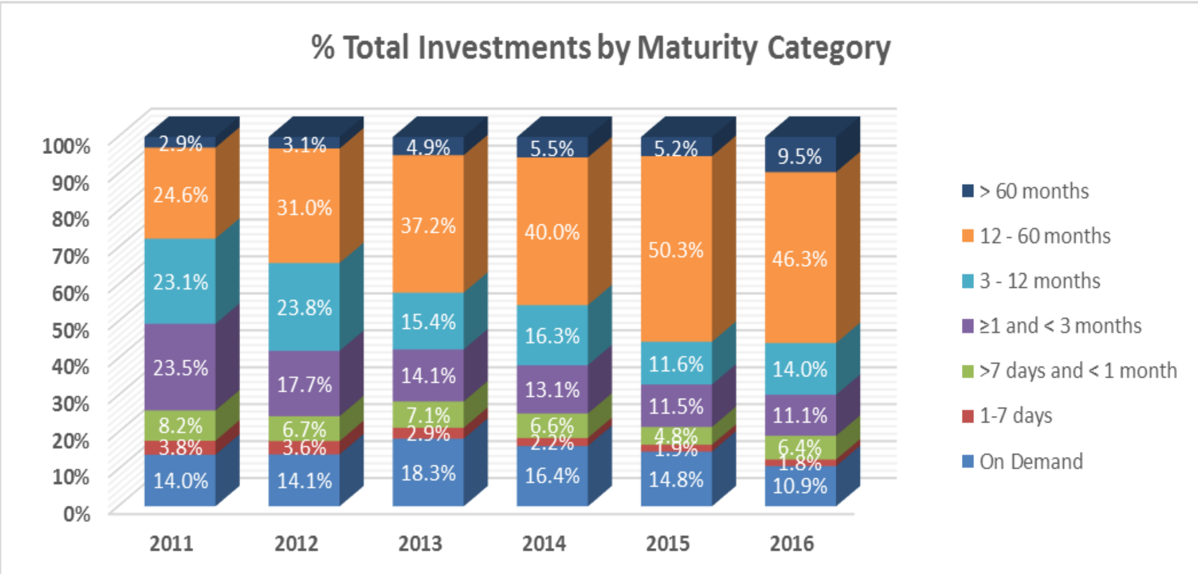
2.3 Current Investment Maturity Profile

The Regulations currently provide that no permitted investment may have a maturity of greater than 10 years. They further provide that no more than 50% of a credit union's total investments may have a maturity of greater than 5 years and that no more than 30% of a credit union's total investments may have a maturity of greater than 7 years.

Chart 4 provides an overview of the maturity profile of credit union investments over the period 2011-2016. It is evident that the maturity profile of sector investments has been steadily increasing during this time with the proportion of total investments maturing after 1 year up from 27% in 2011 to over 55% in 2016.

Given the on-demand nature of the majority of credit union funding (represented by members' savings), when making a decision to invest surplus funds over the longer term, credit unions must ensure that all regulatory liquidity requirements are met as well as ensuring that any such investment takes account of appropriate asset and liability management (ALM).

Chart 4

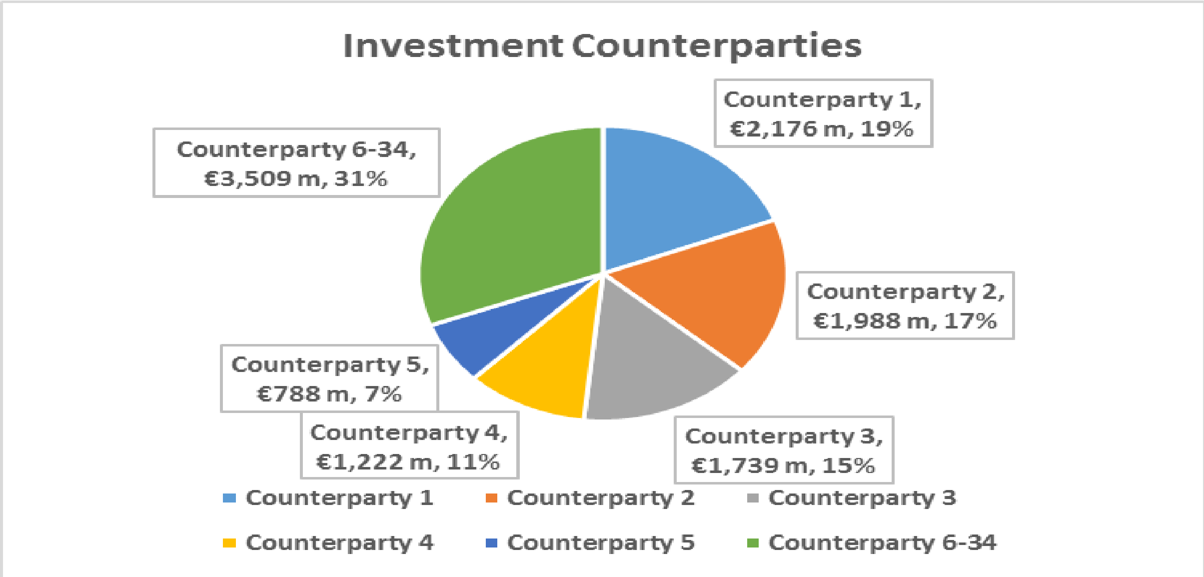


Source: Prudential returns submitted by individual credit unions (December quarter returns)

2.4 Investment Counterparty Exposure

While credit unions currently invest with a wide range of counterparties, a large proportion of their overall investments are held with a small number of counterparties. This is particularly the case with regard to investments held with authorised credit institutions arising from the consolidation in domestic counterparties which has occurred in recent years. Chart 5 depicts the current counterparty exposure across the sector and shows that nearly 70% of total investments held by credit unions are held with only 5 counterparties.

Chart 5



Source: Prudential returns submitted by individual credit unions (December 2016 quarter)

3. Potential Changes to the Investment Framework

The Central Bank is considering a number of potential changes to the investment framework for credit unions. Three new classes of investments into which credit unions may invest surplus funds are being considered. In addition, consideration is also being given to amending the counterparty exposure limit. Notwithstanding any changes which may be made to the investments framework, in accordance with section 43 of the Credit Union Act, 1997 (the 1997 Act) credit unions must manage their investments to ensure that they do not involve undue risk to members' savings and before making an investment a credit union shall assess the potential impact, including the impact on the liquidity and financial position, on the credit union. Credit unions are reminded of their legislative requirement to develop, implement, document and maintain a risk management system with such governance arrangements and systems and controls to allow it identify, assess, measure, monitor, report and manage the risks to which it is, or might reasonably be, exposed to. The Central Bank expects a high and effective degree of governance around investment decisions in credit unions and these should be closely monitored by the board.

Further detail on the potential changes to the investment framework along with potential specified credit quality, maturity and concentration limits are outlined below. As is the case for existing investment classes, credit unions would only be permitted to invest in euro denominated investments in these potential investment classes.

3.1 Investment in Bonds issued by Supranational Entities

The Central Bank is considering permitting credit unions to invest in bonds issued by supranational entities[3]. The following limits are being considered:

i. Concentration Limit:
Maximum investment by a credit union would be limited to 50% of regulatory reserves.

ii. Maturity Limit:
Maximum permitted maturity would be 10 years.

iii. Bond Rating Requirement:
Investment would be permitted only in bonds with a minimum rating of no less than 'A' or equivalent applied by at least two recognised rating agencies.

3.2 Investment in Corporate Bonds

The Central Bank is considering permitting credit unions to invest in corporate bonds. The following limits are being considered:

***i. Concentration Limit*:**
Maximum investment by a credit union would be limited to 25% of regulatory reserves.

ii. Maturity Limit:
Maximum permitted maturity would be 10 years.

iii. Bond Rating Requirement
Permitted investment only in corporate bonds with a minimum rating of no less than 'A' or equivalent applied by at least two recognised rating agencies.

3 An entity formed by two or more central governments with the purpose of promoting economic development for the member states.

3.3 Investment in Tier 3 Approved Housing Bodies (AHBs)

The Central Bank is seeking views through CP109 on whether it is appropriate for credit unions to invest in Tier 3 AHBs taking account of the risks posed and potential impact of such investments. In addition, feedback is sought on how such an investment might be structured and managed by credit unions.

This RIA explores potential impacts for illustrative concentration and maturity limits. The Central Bank is of the view that given the existing current ALM framework for credit unions this would necessitate a relatively low concentration limit to avoid significantly exacerbating the existing mismatch between the maturity profile of the sector's funding and assets.

Concentration Limit:

Three illustrative concentration limits have been considered in this RIA as follows:

(a) Maximum investment by a credit union limited to 12.5% of regulatory reserves;

(b) Maximum investment by a credit union limited to:

   i. 25% of regulatory reserves, for credit unions with total assets of at least €100 million; or

   ii. the lesser of 25% of regulatory reserves or €3 million, for credit unions with total assets of less than €100 million; and

(c) Maximum investment by a credit union limited to 50% of regulatory reserves.

Maturity Limit:

The Central Bank recognises that any investment in AHBs would necessitate a longer duration to existing maturity limits provided under the existing investment framework, given the nature of the investments. A potential appropriate maximum permitted maturity limit is considered to be 25 years.

3.4 Overall Counterparty Limit

The current Regulations place a maximum exposure limit to an individual counterparty of 25% of a credit union's total investments. Consideration is being given to reduction in this limit in order to ensure that no more than 20% of a credit union's total investments may be exposed to an individual counterparty.

4. Analysis of costs, benefits and impacts for each Potential Change

The costs and benefits for credit unions and the credit union sector have been considered collectively for each of the potential changes to the investment framework outlined above. The impact of each of the potential changes including the potential limits has been assessed on an individual and collective basis.

The Central Bank would like to highlight the challenges/limitations associated with undertaking a RIA on these potential additions to the investment framework for credit unions. The analysis on the likely impact of the potential changes to the investment framework has been performed subject to certain assumptions which are specified throughout this paper and in Appendix 1. It is a matter for individual credit unions to set their own risk appetite within the parameters set out in the investment framework. The resulting impact of the potential changes to individual credit unions in terms of their investment portfolio composition and the resulting impact on income and return on assets will be unique to the decisions taken by individual credit unions, as guided by their investment risk appetite. Given the range of options being afforded to credit unions under the investment framework incorporating the potential changes, analysis has concentrated on the likely impact on the balance sheet composition. No specific analysis has been performed on the likely impact on income and return on investments in recognition of the limited potential to generate additional return while maintaining appropriate levels of risk in credit union portfolios.

4.1 Information sources

Data provided to the Central Bank through the quarterly Prudential Return informed the analysis of the impact of the potential changes and associated limits. Where financial data analysis has been performed this is by reference to the December 2016 Prudential Returns submitted by individual credit unions.

Credit unions may wish to provide additional information or data analysis they may have on the potential impact of the potential changes to the investment framework through any responses they provide to CP109.

4.2 Costs

It is not expected that the potential introduction of these new classes of investments would result in a significant increase in the overall cost base for credit unions. Should these investment classes be introduced there would likely be an incremental cost for credit unions to develop their expertise in relation to these investment classes in order to fully understand the risks posed and to ensure that members' funds are not subject to undue risk when investment decisions are being undertaken. Credit unions would also be required to ensure that their existing systems, controls, policies and procedures are updated as necessary and appropriate to reflect the new investment requirements. Credit unions would be required to manage their liquidity and ensure that they have appropriate systems and controls in place for ALM.

There may be fees and commissions payable to investment advisors who may facilitate credit unions in undertaking investment in new classes of investments. Credit unions should ensure that any costs incurred are proportionate to the return provided on such investments.

4.3 Benefits

The potential introduction of additional classes of permitted investments for credit unions would provide opportunities for diversification of investment portfolios. Additional classes of investments may facilitate credit unions in spreading the risk of their investment portfolios over a wider range of products and with a broader range of counterparties. In addition, this may provide an opportunity for credit unions to increase the return earned on investments. However, when undertaking investment the principle of risk return trade-off should be considered carefully. In general, returns will only rise with an increase in investment risk. Credit union investment portfolios should reflect appropriate levels of risk and this will necessarily impact on the level of return that appropriate investment portfolios can generate. Credit unions are reminded of their legislative requirement that investments should be managed to ensure that they do not (taking account of the nature, scale, complexity and risk profile of the credit union) involve undue risk to members' savings. There is a need for credit unions to fully understand the risks associated with all investments and ensure that they are in line with the risk appetite of the credit union.

4.4 Impacts

The impact of each of the potential changes to the investment framework is explored below. Calculations have been performed to assess the maximum permitted investment for the credit union sector and for individual credit unions, based on the suggested concentration limits for each of the potential investment classes. An assessment has also been performed to assess the likely impact on balance sheet maturity profile taking account of the maximum permitted investment in AHBs. A scenario analysis has been performed on three illustrative credit unions to assess the potential impact of the introduction of the three investment classes in aggregate on the existing composition of investment portfolios. Detail on the assumptions used for this analysis is provided in Appendix 1.

4.4.1 Investment in Bonds issued by Supranational Entities

Concentration Limit Analysis

The limit being considered for investment in bonds issued by supranational entities is 50% of regulatory reserves. Table 1 illustrates the maximum permitted investment in bonds issued by supranational entities for the credit union sector for this limit, along with the proportion that such investment might represent as a % of total sector assets and total sector investments.

Table 1

Total Exposure to Bonds issued by Supranational Entities[4]	€895 m
Exposure as a % of Total Assets (average)	5.6%
Exposure as a % of Total Investments (average)	8.3%

Table 2 provides analysis in order to illustrate the range value of investments in bonds issued by supranational entities available to individual credit unions and specific categories of credit union as a result of the potential concentration limit.

Table 2

	Investment €	Investment as a % Total Assets	Investment as a % of Total Investments
Largest Maximum permitted investment[5]	€22.2 m	7%	10.4%
Smallest Maximum permitted investment[6]	€0.06 m	6.3%	10.9%
Average Maximum permitted investment (All credit unions where Total Assets ≥ €100m)	€9.4 m	5.6%	7.9%
Average Maximum permitted investment (All credit unions where Total Assets < €100m)	€1.8 m	5.5%	8.4%

Maturity Limit Analysis

The potential maturity limit for investment in bonds issued by supranational entities is 10 years. This is in line with the existing maturity limit for investments in the Regulations and as a result would not have an impact on the overall maturity profile of investments held by credit unions on the assumption that credit unions when investing in supranational bonds make such investment in line with the maturity of their existing investment portfolio.

Bond Rating Requirement Analysis

The introduction of a bond minimum rating requirement of not less than 'A' or equivalent applied by at least two recognised credit rating agencies is aimed at helping to ensure that the inherent credit risk associated with such investments does not introduce inappropriate levels of risk into credit union investment portfolios. The Central Bank would require that where a bond is held in a supranational entity and that bond no longer meets the minimum rating requirement, the credit union would be required to divest of the bond as soon as possible in order to ensure compliance with the regulations and to ultimately appropriately manage the risk of its investment portfolio.

4.4.2 Investment in Corporate Bonds

Concentration Limit Analysis

The limit being considered for investment in corporate bonds is 25% of regulatory reserves. Table 3 illustrates the permitted maximum investment in corporate bonds for this limit along with the proportion that such investment might represent as a % of total assets or total investments.

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4 Calculated by applying the potential concentration limit to the regulatory reserve of each individual credit union and aggregating for all credit unions.

5 Calculated by applying the potential concentration limit to the regulatory reserve of each individual credit union and identifying the credit union with the largest maximum permitted investment.

6 Calculated by applying the potential concentration limit to the regulatory reserve of each individual credit union and identifying the credit union with the smallest maximum permitted investment.

Table 3

Total Exposure to Corporate Bonds[4]	€448 m
Exposure as a % of Total Assets (average)	2.8%
Exposure as a % of Total Investments (average)	4.2%

Table 4 provides analysis in order to illustrate the range value of corporate bonds available to individual credit unions and specific categories of credit union as a result of the potential concentration limit.

Table 4

	Investment €	Investment as a % Total Assets	Investment as a % of Total Investments
Largest Maximum permitted investment[5]	€11.1 m	3.5%	5.2%
Smallest Maximum permitted investment[6]	€0.03 m	3.1%	5.5%
Average Maximum permitted investment (All credit unions where Total Assets ≥ €100m)	€4.7 m	2.8%	4%
Average Maximum permitted investment (All credit unions where Total Assets < €100m)	€0.9 m	2.8%	4.2%

Maturity Limit Analysis

The potential maturity limit for investment in corporate bonds is 10 years. This is in line with the existing maturity limit for investments in the Regulations and as a result would not have an impact on the overall maturity profile of investments held by credit unions on the assumption that credit unions when investing in corporate bonds make such investment in line with the maturity of their existing investment portfolio.

Bond Rating Requirement Analysis

The introduction of a minimum rating requirement of not less than 'A or equivalent' applied by at least two recognised credit rating agencies for investment in corporate bonds is aimed at helping to ensure that the inherent credit risk associated with such investments does not introduce inappropriate levels of risk into credit union investment portfolios. The Central Bank would require that where a corporate bond is held and it no longer meets the minimum rating requirement, the credit union would be required to divest of this bond as soon as possible in order to ensure compliance with the regulations and to ultimately manage the risk of its investment portfolio.

4.4.3 Investment in Tier 3 Approved Housing Bodies

CP109 seeks views on the appropriateness of credit unions investing in Tier 3 AHBs for the provision of social housing. This is a potential investment class which is under consideration by the Central Bank.

Concentration Limit Analysis

As outlined in section 3.3 of this RIA, three illustrative potential limits for this investment class have been explored. These illustrative limits will be further considered when feedback on this potential class of investment is received through responses to CP109. The Central Bank views that a relatively low concentration limit is appropriate for this class of investment to take account of the existing ALM framework for credit unions and the maturity mismatch which already exists on credit union balance sheets.

Analysis has been performed on these illustrative concentration limits to assess the likely impact that such limits would have on the investment portfolios of credit unions and are presented in Table 5. This analysis is based on the assumption that all credit unions undertake investment in Tier 3 AHBs to the maximum permitted investment amount under each illustrative concentration limit (based on the credit union's total asset size).

Table 5

Potential Concentration Limit	A 12.5% Reg Reserve	B 25% Reg Reserve	B 50% Reg Reserve
Total Sector Exposure to Tier 3 AHB[4]	€224m	€448m	€895m
Tier 3 AHB Investment represented as a % of Total Assets (average)	1.4%	2.8%	5.6%
Tier 3 AHB Investment represented as a % of Total Investments (average)	2.1%	4.2%	8.3%

Further analysis was conducted to ascertain the impact such a concentration limit would have on credit unions with total assets of at least €100 million and total assets of less than €100 million and is summarised in tables 6 and 7 below.

Table 6 - Impact of Illustrative Concentration Limits for Tier 3 AHB Investments for Credit Unions with Total Assets ≥ €100 million

Potential Concentration Limit	A	B	C
Number of Credit Unions[7]	50	50	50
Total Exposure to Tier 3 AHBs	€117 m	€234 m	€468 m
Tier 3 AHB Investment represented as a % of Total Assets (average)	1.4%	2.8%	5.6%
Tier 3 AHB Investment represented as a % of Total Investments (average)	2%	4%	7.9%
Largest Maximum permitted Tier 3 AHB investment[5]	€5.6m	€11.1 m	€22.2 m
- As a % Total Assets	1.8%	3.5%	7%
- As a % Total Investments	2.6%	5.2%	10.4%
Smallest Maximum permitted Tier 3 AHB investment[6]	€1.2m	€2.4m	€4.9
- As a % Total Assets	1.2%	2.4%	4.9%
- As a % Total Investments	1.9%	3.8%	7.5%

Table 7 - Impact of Illustrative Concentration Limits for Tier 3 AHB Investments for Credit Unions with Total Assets < €100 million

Potential Concentration Limit	A	B	C
Number of Credit Unions[8]	237	237	237
Total Exposure to Tier 3 AHBs	€107 m	€214 m	€427 m
Tier 3 AHB Investment represented as a % of Total Assets (average)	1.4%	2.8%	5.5%
Tier 3 AHB Investment represented as a % of Total Investments (average)	2.1%	4.2%	8.4%
Largest Maximum permitted Tier 3 AHB investment[5]	€1.5m	€2.9 m	€5.9m
- As a % Total Assets	1.5%	3%	6%
- As a % Total Investments	2.2%	4.5%	8.9%
Smallest Maximum permitted Tier 3 AHB investment[6]	€0.01m	€0.03m	€0.06m
- As a % Total Assets	1.6%	3.1%	6.3%
- As a % Total Investments	2.7%	5.5%	10.9%

7 Based on the number of credit unions submitting a Prudential Return for Dec 2016
8 Based on the number of credit unions submitting a Prudential Return for Dec 2016

Maturity Limit Analysis

The potential appropriate maturity limit being considered by the Central Bank for investment in AHBs is 25 years. The current maturity limit for credit union investments is 10 years.

Table 8 outlines the current maturity profile of investments maturing after 5, 7 and 10 years as a percentage of total sector investments and total sector assets and the resulting likely shift in such percentages on the assumption of investment in Tier 3 AHBs up to the maximum permitted investment amount. This analysis is based on illustrative concentration limit B as outlined in section 3.3 of this RIA. This illustrative concentration limit was selected to inform this maturity analysis as it represents the mid-point in the illustrative concentration limits explored above.

This maturity analysis assumes that overall sector assets and investments remain as is and the investment in Tier 3 AHBs is allocated from the existing investment portfolio of credit unions (from the on demand and maturing in less than 1 year category).

Table 8

	Investments > 5 year maturity	**Investments > 7 year maturity**	**Investments > 10 year maturity**[9]
Current			
Investment by category as a % Total Investments (average)	7%	2.1%	0.05%
Investment by category as a % of Total Assets (average)	4.9%	1.5%	0.04%
Post* *Maximum Tier 3 AHB Investment			
Investment by category as a % Total Investments (average)	11.2%	6.3%	4.2%
Investment by category as a % of Total Assets (average)	7.7%	4.3%	2.8%

Table 9 shows the current maturity profile of the sector balance sheet.

9 Prior to the introduction of the Credit Union Act 1997 (Regulatory Requirement) Regulations 2016 there was no maximum maturity limit for investments specified in legislation or regulation. The investments held with maturity > 10 years by credit unions are legacy investments held prior to commencement of the Regulations.

Table 9

Maturity Profile	On Demand and Less than 1 Year	1-5 Years	5-10 Years	> 10 Years	No Maturity	Total
Cash, Min Reserve and Deposit Protect Acc	€570.5 m					€570.5 m
Investments	€5,049.6 m	€5,285.4 m	€1,080.1 m	€6.1 m		€11,421.1 m
Loans	€332.4 m	€3,259.7 m	€432.0 m	€112.7 m		€4,136.8 m
Less Provisions *	-€35.2 m	-€345.6 m	-€45.8 m	-€11.9 m		-€438.6 m
Fixed Assets					€316.5 m	€316.5 m
Other Assets					€88.4 m	€88.4 m
Total Assets	**€5,917.2 m**	**€8,199.5 m**	**€1,466.3 m**	**€106.8 m**	**€405.0 m**	**€16,094.8 m**
Members Savings	€11,957.8 m	€1,298.2 m	€92.6 m	€16.2 m		€13,364.9 m
Other Liabilities					€74.1 m	€74.1 m
Other Borrowings					€1.8 m	€1.8 m
Total Liabilities	**€11,957.8 m**	**€1,298.2 m**	**€92.6 m**	**€16.2 m**	**€76.0 m**	**€13,440.8 m**
Net Worth	**-€6,040.6 m**	**€6,901.2 m**	**€1,373.7 m**	**€90.6 m**	**€329.0 m**	**€2,654.0 m**
Regulatory Reserves					€1,790.5 m	€1,790.5 m
Operational Risk Reserve					€87.0 m	€87.0 m
Other Realised Reserves					€755.0 m	€755.0 m
Other Unrealised Reserves					€18.0 m	€18.0 m
Proposed Diviend and Loan Int Rebate					€3.5 m	€3.5 m
						€2,654.0 m

* Total provisions have been allocated to each maturity category on a pro-rata basis to the loans held in each maturity category

The current maturity mismatch on the sector balance sheet is pronounced and stands in excess of €6 billion with €5.9 billion in assets due to mature in less than 1 year and close to €12 billion in savings repayable on demand or in less than 1 year (as these are sector averages the profile of individual credit unions may not reflect sector wide trends in all cases). Any investment by credit unions in Tier 3 AHBs will result in increasing this maturity mismatch by the amount of the Tier 3 AHB investment (on the assumption that any investment in Tier 3 AHBs is taken from the less than 1 year maturity investment category).

The potential risks associated with this mismatch may be somewhat mitigated by relative stickiness of member savings which has been evidenced in recent years and the current high levels of liquidity across the sector. Total members' savings in credit unions proved stable during the crisis, they were €12.4bn at the end of 2008, reduced slightly to €11.7bn during the period to 2013 and now stand at €13.4bn.

In addition, credit unions are required to maintain liquid assets of not less than 20% of unattached members' savings. Section 85A(2) of the Credit Union Act, 1997 requires that a credit union shall at all times keep a proportion of its total assets in liquid form so as to enable the credit union to meet its obligations as they arise. The proportion of assets kept in liquid form shall take into account the nature, scale and complexity of the credit union, and the composition and maturity of its assets and liabilities. The average sector liquidity ratio is currently 46% and all credit unions are currently in compliance with the liquidity requirement. However, before undertaking any investment in Tier 3 AHBs, credit unions would need to assess the interplay between a possible move to longer term lending, combined with longer maturity investments and consideration should be given as to how to appropriately lengthen the funding profile to accompany such changes. As set out in CP109 credit unions undertaking longer term investments will be expected to take steps to ensure that they maintain appropriate levels of liquidity.

4.4.4 Overall Impact Analysis

While consideration has been given to the impact of each of the potential classes of investments and associated limits in isolation, the below analysis focuses on the incorporation of the potential investment classes within the existing investment framework and the existing composition of sector investments.

Scenario analysis has been performed aimed at assessing the likely impact of the potential investment classes on the investment composition of an individual credit union. Detail of the parameters and assumptions used for this analysis are included in Appendix 1.

Charts 6-8 illustrate the current composition of sector investments and display the resulting potential change in composition where a credit union invests in the potential investment classes to the maximum potential permitted concentration limits and to 50% of the maximum potential permitted concentration limits. The potential maximum concentration limits used for this analysis are as follows:

(a) Bonds issued by Supranational Entities- 50% of regulatory reserves;
(b) Tier 3 AHB Investments- 25% of regulatory reserves for credit unions with total assets ≥ €100 million or the lesser of 25% of regulatory reserves or €3 million for credit unions with total assets < €100 million; and
(c) Corporate Bonds- 25% of regulatory reserves.

This analysis has been conducted on 3 illustrative credit unions of varying asset size.

As can be seen the introduction of additional investment classes into the investment framework would provide a mechanism for credit unions to gain additional diversification in investment product. This also provides scope for further diversification of counterparty exposure and an opportunity to generate varying investment rates of return on different investment products.

Chart 6 - Illustrative Credit Union with Asset Size €150m

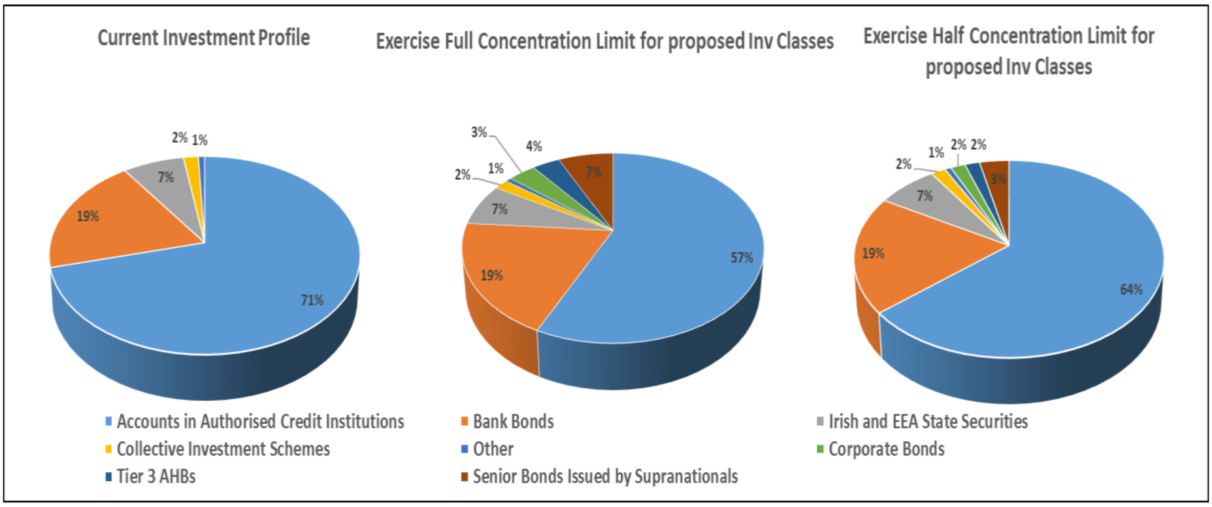


Chart 7 - Illustrative Credit Union with Asset Size €50m

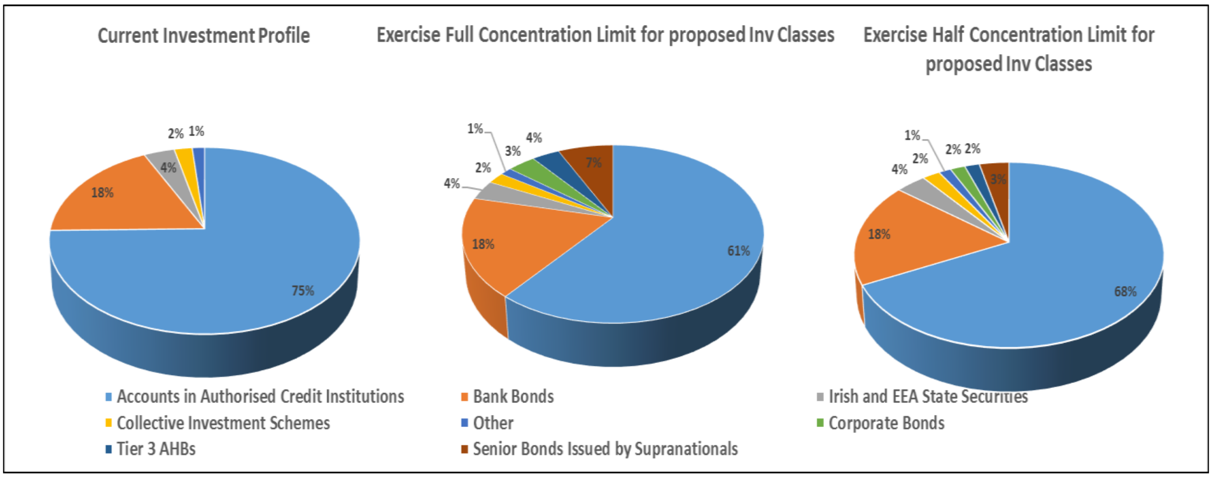
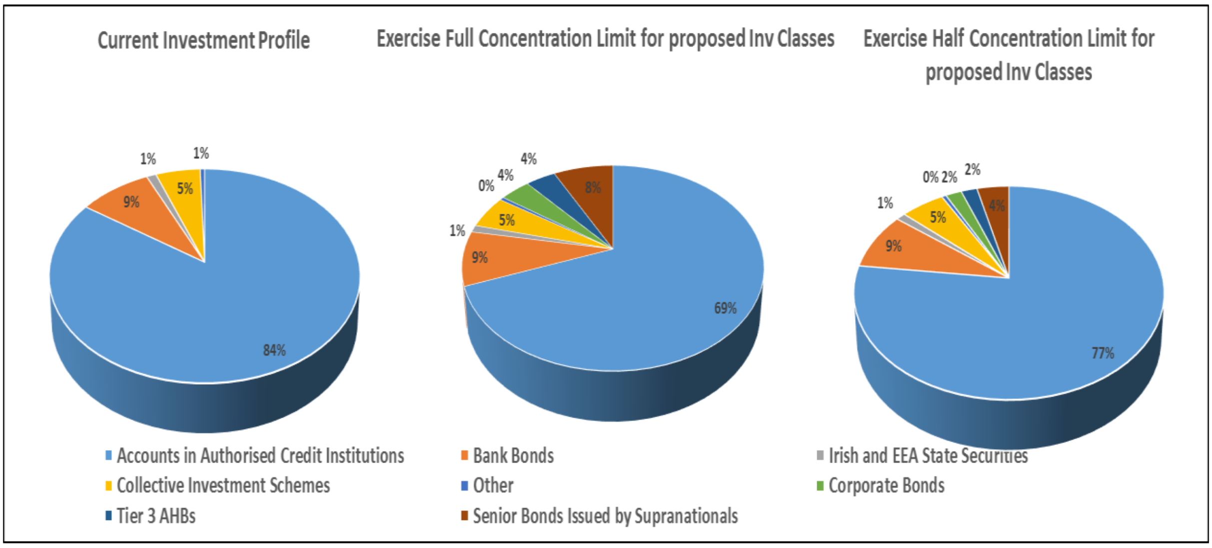


Chart 8 - Illustrative Credit Union with Asset Size €24.5m



4.4.5 Overall Counterparty Limit

It is being considered to potentially reduce the maximum counterparty exposure limit from 25% of total investments to 20% of total investments. It is also considered appropriate that credit unions would have a 12-month transitional period to become compliant with this revised requirement. Analysis shows that c.86% of credit unions currently have an exposure to a counterparty which is in excess of 20%. It should be noted that credit union sector investments are currently held with in excess of 30 different counterparties. Given the range of counterparty options currently available to credit unions and acknowledging that this will be expanded with the introduction of potential investment classes and taking account of the proposed transitional arrangement, it is not considered that the reduction in the counterparty exposure limit to 20% will pose a significant compliance challenge for credit unions.

5. Consultation

As outlined in the Consultation Protocol for Credit Unions issued on 27 November 2012, the Central Bank has committed to consult on proposed new regulations, which in the Central Bank's view, will have a significant impact on the business of credit unions.

Consultation on potential changes to the investment framework for credit unions is contained within CP109. This RIA is included as an Appendix within the consultation paper.

6. Enforcement and Compliance

The responsibility for enforcing and ensuring compliance with the investment regulations for credit unions will rest with the Central Bank.

7. Review

The Central Bank will consider the feedback received on CP109 and this RIA before publishing final investment regulations for credit unions. The Central Bank commits to performing and publishing an analysis on credit union sector investments two years post commencement of the new investment regulations for credit unions to assess and analyse the actual impact which any changes to the regulations have had.

8. Publication

The RIA will be published as part of CP109 which is available at www.centralbank.ie

Appendix 1

The following analysis and assumptions were made in assessing the likely impact of the potential new classes of investments on investment portfolio composition for credit unions:

i. Current credit union sector investments were stratified into asset buckets to ascertain the current[10] average investment to asset ratio for that particular asset bucket.

   Asset buckets used:
   (a) Credit Unions with Total Assets greater than or equal to €100 million;
   (b) Credit Unions with Total Assets less than €100 million and greater than €25 million
   (c) Credit Unions with Total Assets less than or equal to €25 million.

ii. A similar exercise was conducted to ascertain the current[10] average proportion of total investments by investment product currently held in each investment product for each of the asset buckets.

iii. The ratios established at (i) and (ii) were applied to three illustrative credit unions with a total asset size of €150 million, €50 million and €24.5 million to establish the total investment amount and the current investment composition for each of these illustrative credit unions. The ratios applied were based on the average asset profile of the relevant asset bucket.

iv. It was assumed that the total regulatory reserves for each of the three illustrative example credit unions were equal to 10% of the total assets.

v. Two scenarios were performed to assess the likely change which the potential classes of investments would have on the current investment composition for each of these illustrative credit unions, based on:
   (a) The maximum permitted concentration limit being exercised; and
   (b) 50% of the maximum permitted concentration limit being exercised.

vi. The maximum concentration limits used at (v) for each of the potential classes of investment were as follows:
   (a) Bonds issued by Supranational Entities- 50% of regulatory reserves;
   (b) Corporate Bonds- 25% of regulatory reserves; and
   (c) Tier 3 AHB Investments- 25% of regulatory reserves for credit unions with total assets ≥ €100 million or the lesser of 25% of regulatory reserves or €3 million for credit unions with total assets < €100 million.

vii. Analysis assumes that any investment in new classes of investments comes from investments currently held in accounts in credit institutions and the total amount of overall investments remains flat.

The resulting impacts are presented in charts 6-8.

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10 Based on Dec 2016 prudential returns submitted by credit unions.

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