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Central Bank of Ireland  
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28 June 2017

**Submission in relation to Consultation Paper CP109:-  
Consultation on Potential Changes to the Investment Framework for Credit Unions**

**On behalf of An Post Employees' Credit Union**

Dear Sir or Madam

An Post Employees' Credit Union (APCU) aims to meet the savings and personal borrowing needs of those who have made their livelihoods through the postal service and their families. Established in 1968, it has 6,100 members and assets of €50M. A member owned co-operative, it is run independently from An Post.

APCU welcomes the opportunity to comment on consultation paper CP109. Our comments and feedback are set out below.

The first section of the submission addresses the eighteen questions raised in CP109. The second section makes some additional comments.

**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. We believe that there is very little diversification in CU investment portfolios. Limiting investment outlets to bank deposits, bank bonds and sovereign bonds is a very large barrier. With the yields on sovereign bonds so low, it is unsurprising that investment portfolios are very heavily weighted towards bank deposits and bank bonds. Expanding the number of investment classes can only help.

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? APCU believes strongly that additional investment classes are needed and that Supranational bonds, corporate bonds and investments in Approved Housing Bodies, as suggested, would be appropriate. They would provide useful diversification away from the financial sector – over-reliance on bank investments caused contagion during the financial crisis.

3. Taking account of the appropriate risk profile for credit union investments, are there any additional investment classes that the Central Bank should consider? If so, please outline the investment classes and why such investment classes are considered appropriate for credit unions. We believe that equity investments, insurance funds and sterling/ dollar sovereign bonds should be considered. (i) In relation to **equities**, we disagreed strongly in January 2016 with the removal of equities as a permitted investment vehicle for credit unions, just because of the existing low usage. Equities have a useful role for managing volatility in a diversified investment portfolio and may be useful to credit unions in the future. Equities would assist in the development of balanced funds for credit unions by third parties. This is an opportunity to reverse the January 2016 decision and to allow a maximum exposure to equities of, say, 5% of total investments, the same limit that applied previously (ii) In relation to **insurance funds**, we are disappointed that CP109 does not allow for investment in insurance funds. While credit unions need to be wary of possible high charges in this area, some well-designed insurance products may be useful (iii) In relation to **sterling/ dollar denominated sovereign bonds**, we believe that a small exposure should be allowed to these massive bond markets, even if there is a currency risk to be managed as part of the investments process.

#### **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? Yes, we agree strongly.

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. APCU believe that the Central Bank has shown no rationale for linking concentration limits to the size of the regulatory reserve and that such limits should continue to be expressed as a percentage of total investments. In this regard, we believe that 15% of total investments is a reasonable upper limit for this investment class. We suggest this limit on the basis that the limit should be sufficiently high to be useful but should not be as high as to create an over-concentration of investment risk.

#### **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? We are strongly supportive of the move to include corporate bonds because it provides diversification away from the banking sector and allows some exposure to utility companies, infrastructure finance and large corporates among others.

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. Again, we believe that no rationale has been shown for linking concentration limits to the size of the regulatory reserve and that such limits should continue to be expressed as a percentage of total investments. In this regard, we believe that 20% of total investments is a reasonable upper limit for this investment class. We suggest this limit on the basis that the limit should be sufficiently high to be useful but should not be as high as to create an over-concentration of investment risk.

#### **Investments in Approved Housing Bodies:**

8. Do you think it is appropriate for credit unions to undertake investments in AHBs? If so, please provide a rationale. Yes, it would provide useful investment diversification and a stability of investment income while reflecting our social ethos. Locking-in a very low rate of return at this point in the interest cycle might be a problem but the regulations would be in place for future investments.

9. What would the most appropriate structure for investments in AHBs be e.g. investment vehicle? Some type of special purpose vehicle, unit trust or other investment fund would be ideal, possibly administered by a firm of Stockbrokers. With low interest rates at present, the amount of fund overheads and charges would be critical.

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? We believe that counterparty risk is significant, particularly with AHB organisations not fully regulated. A possible mitigating step might be a requirement to conduct significant due diligence on the individual AHB, focusing on governance standards and financial strength. Another possible mitigating step would be to ensure that any investments are secured by specific housing assets. Interest rate risk (i.e. the rate agreed initially proving unsuitable over the medium to long term) is another significant risk, particularly given the length of such investments. A possible mitigating step would be an interest rate review every seven years and an adjustment based on some agreed benchmark.

11. How can the ALM issues associated with such investments be addressed by credit unions? We believe that the nature of the retail banking and credit union sectors creates ALM issues that can only be resolved partially. ALM concerns at credit unions are addressed currently by (i) the historical "stickiness" of member savings (ii) generous insurance benefits that tends to lock-in savings (iii) the existing pattern of short term, unsecured lending and (iv) the extraordinarily high reserves at individual credit unions. As

we move beyond the current interest rate cycle, it is likely that credit unions will develop a range of fixed rate savings options for members and this will help to address ALM issues.

12. Given the existing mismatch between the maturity profile of the sector's funding and assets and the likely maturity profile of such investments, the Central Bank is of the view that the concentration limit would need to be set at a level that reflects this. Do you have any views on what an appropriate concentration limit would be for such an investment? What liquidity and ALM requirements could be introduced to mitigate these risks and potentially facilitate a larger concentration limit? APCU believes that a concentration limit of 20% of total investments might be appropriate for AHB investments but we acknowledge that it would take many years to build up to this level of investment. Again, we believe that the limit should be sufficiently high to be useful but should not be as high as to create an over-concentration of investment risk. We believe that existing liquidity requirements are very conservative and should be sufficient. In relation to ALM requirements, with none in place at present a study needs to be conducted to investigate what is happening on this front other in credit union movements overseas, taking into account our concentration on short term, unsecured lending.

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? APCU agreed with this proposal.

#### **Counterparty Exposure Limit:**

14. Do you have any comments on the proposal to amend the existing counterparty limit for credit union investments? If you have suggestions, please provide them along with supporting rationale. We would be hostile to the notion of reducing counterparty exposure limits to 20% from 25%. A limit of 20% effectively means an 18% limit, given the need to maintain a "compliance buffer". At a time when deposit takers are withdrawing from the market or are reducing their acceptance of CU deposits by way of their pricing mechanisms, a reduction in limits is completely inappropriate. This issue might be revised when RCU is conducting its two year review.

15. Do you have any comments on the proposed transitional arrangement to reduce the counterparty limit to 20% of total investments? No, a reduction in counterparty exposure limits cannot be considered at this time.

#### **Collective Investment Schemes:**

16. Do you have any comments on the use of collective investment schemes for credit union investments? We would like to see more offerings of collective investment schemes to credit unions by the funds and stockbroking community. They are useful for spreading counterparty risk and for effective reporting on fund performance. Unfortunately, charging and transparency can be issues.

17. Are there any barriers to credit unions using collective investment schemes in the existing investment regulatory framework? APCU are not aware of any barriers. The main reasons for such a low take-up at present is because (i) twice in a generation (1994 and 2008) we have seen the collapse of credit union collective investment schemes, managed by two separate Irish based institutions and (ii) there appears to be no appetite to offer further schemes to credit unions or to sponsor them.

#### Timelines:

18. Do you agree with the proposed timelines for the introduction of potential changes to the investment framework set out in this consultation paper? If you have other suggestions please provide them, along with the supporting rationale. We would like to see additional counterparties such as supranational bonds, corporate bonds and AHBs introduced as soon as possible. As outlined above, we believe that any consideration of reducing counterparty exposure limits should be deferred for at least two years.

#### Some additional comments:

- a. We believe that the current immediate and 90 day **liquidity limits** are becoming very challenging for the sector in terms of avoiding capital losses. We suggest that sovereign and bank bonds be included for immediate and 90 day liquidity calculations, perhaps with a notional “haircut”. We understand that a recognition of the liquidity of bonds is already made in respect of other regulated firms and there needs to be consistency and fairness among firms.
- b. RCU are proposing to prohibit the newer generation of **bank bonds** that are emerging (such as senior bank bonds that might be subordinated to other senior obligations in the capital structure or bonds issued by bank holding companies). We believe very strongly that credit unions should be allowed to use these bonds, recognising that a higher level of investment risk is involved.
- c. It looks like the Central Bank is **proposing to further tighten the credit union investment universe** (which is already highly restricted) by almost eliminating future bank bond investments and reducing counterparty exposure limits. Allowing a limited exposure to corporate bonds, supranational bonds and approved housing bodies will offer **very little compensation** because of the small investment returns available from each and the extremely long term nature of housing investments.
- d. Due to the **current interest rate environment** and ECB QE programme, there is very little appetite for deposits among banks. This is particularly so in the case of credit union deposits because of BASEL III. With such limited investment outlets available to credit unions, this is not the time to be adding further restrictions in the form of counterparty exposure limits and bank bond restrictions.
- e. Part of the responsibility of the Central Bank in relation to credit unions is “the maintenance of the financial stability and well-being of credit unions generally”.

Helping to make credit unions unviable by restricting bank bond investments and reducing counterparty limits and by not including bond investments in liquidity measures does not appear to be a good way of achieving the Bank's statutory responsibilities.

The Board, management and the Liquidity & Investments Committee of An Post Employees' Credit Union hope that the above comments are useful in your discussions.

Yours faithfully

  
**COLUM BRENNAN**  
Secretary

  
**PAUL RYAN**  
Manager