Lucan District
CREDIT UNION
building a better community

Registry of Credit Unions
Central Bank of Ireland
P.O. Box 559
New Wapping street
North Wall Quay
Dublin 1

27th June 2017

Re: Consultation on Potential Changes to the Investment Framework for Credit Unions.

Dear Sir/Madam

The Board and Management of Lucan District Credit Union Ltd. wish to thank Central Bank for the invitation extended to submit our views on the matters outlined in the consultation paper CP109. We wish to respond as follows:

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

The current issue with the available diversification options is the shrinking number of available counterparties due to banks withdrawing from the Irish market and/or reducing their rates to zero or negative rates on short term deposits. We feel that this could potentially increase risk for members funds as credit unions may look to counterparties who may not be as secure in order to comply with the counterparty limit and/or to secure positive return.

Increasingly brokers are looking at more complex financial instruments to secure some return for credit unions. Return is usually dependent on the performance of Euribor or a selection of shares over a specific time period. The capital within these instruments is generally guaranteed however, the FRS102 accounting rules have made the accounting for these instruments much more difficult and problematic. We would question the security of some of these products and the transparency of the actual return.

The limiting of deposits/investments to those denominated in euro only is a constraint where good returns can be achieved through the purchase of bank/government bonds in A-rated institutions in other currencies. Where the skills to manage accounting for exchange rate fluctuations are available within credit unions this should be permitted. We would not recommend FX speculation but rather permission to invest in specific, limited types of FX investments in A-rated institutions/countries only.

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?

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We are delighted that the Central Bank is reviewing the current investment framework as this has not been reviewed since 2006. Much has changed on the investment landscape since then. The current consultation paper does outline the types of additional investments that the Central Bank is considering.

We feel that allowing the purchase of supranational bonds and corporate bonds will allow some small diversification of the portfolio and provide additional counterparties but will not have any significant impact on investment portfolios.

We would have a concern around the structure of investments in approved housing bodies as the proposed investment vehicle has not been fully outlined. As our mutual priority is to protect our members funds we would need to understand who will provide the guarantee on this type of investment. Will this be a government guarantee? Will it be a government issued bond? The AHBs are currently only regulated under a Voluntary Regulatory Code as opposed to credit unions who are heavily regulated and supervised. They are not rated institutions as are banks and sovereign states. Without a government guarantee we fail to see how investments in AHBs would be suitable for our members funds.

In addition, the proposed maturity on these investments could run to 25 years. We would have a concern about the accessibility of members funds during the period of investment, for example, government or bank bonds could be traded on the open market should funds need to be released. How accessible would AHB investments be should funds be required by credit unions? Would the investment be locked away for 25 years?

Restricting the purchase of bank bonds issued by holding companies of banks will increase pressure on credit unions as banks begin to move to this structure. As current bonds mature it will become impossible to purchase newly issued bonds. We feel that this will reduce bank bonds held in portfolios considerably. Over time, there would be only a very small percentage of the portfolio invested in the limited bank bonds available.

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.

As mentioned in point 1 above, we feel that limited investment into A-rated government and bank bonds in other currencies could be permitted. For example, Norway is A-rated and the yields on these bonds are good at present. The funds would be fully secure for members and exchange rate fluctuations could be managed effectively. This would be no different than accounting for bonds mark-to-market on a monthly basis.

If the Central Bank are considering permitting credit unions to invest in 25 year AHB investments perhaps consideration could be given to extending the maturity period for government bonds to allow investment in longer term Irish Government bonds e.g. the 2030 bond. Credit unions would have the option of divesting these on the open market if liquid funds were required during the investment period.

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?

We agree with the proposals on the inclusion of supranational bonds, the credit rating and maturity limits. This will provide some additional diversification to a portfolio although they will most likely not provide additional investment income.

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

We agree with the concentration limit proposed. It is unlikely that supranational bonds would form a significant percentage of an investment portfolio.

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 agree with the inclusion of corporate bonds in the list of authorised investments and with the minimum credit rating and maturity limit. They will provide additional diversification opportunity for credit unions but are unlikely to contribute significantly to investment income.

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.

The suggested concentration limit would allow for a very small investment in this area as a proportion of the total portfolio. Where a corporation is rated A by two institutions it may be better that a limited percentage of the total portfolio is permitted for investment rather than a percentage of the reserves. Credit unions could divest of these investments on the open market should the requirements change or where the corporation no longer qualifies.

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

As outlined in CP109 we currently can't see how investments in AHBs would be suitable for credit unions. Given that the protection of members funds is the priority, capital invested should be guaranteed. In this scenario, who will provide the capital guarantee for this type of investment. We also have significant concerns around the current nature of the regulation of these bodies and also the fact that they are unrated agencies.

The requirement for specialist professional advice would make such investments in this category costly which may negate any expected return. The 'development risk' element would be unacceptable in any other credit union investment class.

This class of investment would appear too costly and high risk as outlined in CP109.

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

As social housing supply is a responsibility of government then any investments into social housing should be guaranteed by the government. Credit Unions are in a position to support the governments social housing provision strategy and we would be delighted to be involved by providing funds. We propose that the government issue a social housing bond which would operate in the same manner as current government bonds. This would guarantee the capital for credit unions and make this investment much more attractive with lower risk attached.

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 feel that the key risks associated would include:

- How is the capital investment guaranteed?
- Development risk with this class of investment.
- Requirement to seek costly specialist advice may make this investment untenable.
    - Given recent property development history in Ireland it has been shown that the specialists aren't always correct in their assessments.
- AHBs are unrated agencies and operate under a voluntary regulatory code.
- Accessibility to some or all members funds, if required, during the very long investment period.

The simple way to mitigate these risks is to package the investment as a bond which can be traded on the open market. These bonds would be issued by the government and guaranteed by the government.

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

Credit unions would be required to hold increased liquidity to cover such long-term investments. This would place additional pressure on credit unions who are already struggling to place liquid funds on deposit at zero rate. In the current investment environment placing funds out for such a long period may be inappropriate.

Any gains made on longer term investments would be fully negated by the cost of holding additional liquid funds. Again, longer terms investments, particularly higher risk investments, would not be an attractive proposition in the current environment.

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

We agree that the concentration limit for such investment should necessarily be small to reduce the risk in so far as possible.

Where funds are placed for 25 years additional liquidity would be required to counterbalance the extended maturity profile of the credit union. The Central Bank has already indicated that liquidity would need to be further reviewed in light of any changes to the investment framework.

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?

We have made our comments in relation to this class of investment in point 8, 9 and 10 above.

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 feel that the current counterparty exposure limit is appropriate and that if anything the limit should increase to 30% rather than decrease. The pressure on credit unions at present to seek out new counterparties is counterproductive and increasing risk where counterparties may not be suitable or not as well capitalised as the larger banks. Credit unions may feel forced to move funds into areas which they feel are higher risk, simply to comply with a very low counterparty limit imposed by regulation.

The currently available Irish banks for example, are limited in number and are offering very low to negative rates. To limit investment in counterparties to 20% would force money out of Irish banks and into European and US Banks.

It would be beneficial if we could increase our deposits in Irish based banks to 30% and it would certainly ease pressure on credit union investment portfolios.

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

As in 14 above, we feel that an increase in counterparty limits would be more appropriate. Reducing counterparty limits to 20% will see a rush of funds to non-Irish banks.

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

While collective investment schemes do offer credit unions a small chance to diversify the portfolio. There are not many options available currently for this type of investment and very little by way of yield. We would not see changes to this category having any impact on credit union investment portfolios.

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

The only real barrier at present to using a collective investment scheme is the lack of availability of such schemes.

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

We agree with the proposed timelines for the introduction of any changes to the investment framework. However, we would urge the Central Bank to fully review the proposals from the viewpoint of credit unions. It is also the priority for credit unions to protect our members funds.

Conclusion

While we welcome the addition of some investment classes we feel that the proposals to reduce the counterparty limit and restrict bank bonds will considerably increase the pressure on credit unions in the current investment environment. The AHB investment proposal, as outlined in the CP109 document, is a wholly unsuitable vehicle for credit union investment where the security of members funds is the priority.

Overall, we feel that the proposals place more restrictions and will make investment decisions much more difficult for credit unions. As a result, we believe that the proposals will increase the risk within credit union investment portfolios, not decrease it as intended.

Yours faithfully

Paula Maguire
CEO