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<u>CP109 Consultation on Potential Changes to the Investment Framework for Credit Unions</u>

Merrion Capital Group welcome the opportunity to submit comments and views to the proposed investment framework for Credit Unions. We have carefully reviewed CP109 proposals and set out below our comments:

Potential Additional Investment Classes

- Bonds issued by Supranational Entities
- Corporate Bonds
- Investments in Tier 3 Approved Housing Bodies3 (AHBs)

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.

Diversification of credit union investment portfolios across counterparty, maturity and asset class is a very important aspect of the prudent management of credit union investments. At present, many credit unions have most of their investment portfolios invested with the 3 domestic Irish banks, we would favour a move to reduce this overweight exposure and to balance it out with an allocation to other highly rated investment grade bank deposits, senior bonds, Euro sovereign bonds and additional asset classes as they become available for investment.

2. Do you have any comments on the potential introduction of additional investment classes for credit unions and the appropriateness of the classes being considered by the Central Bank?

We welcome the introduction of additional investment classes for credit unions.

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.

Equities. We believe credit unions that have demonstrated that they have the knowledge, expertise and have the required risk management systems in place should be permitted to invest in equities. Additionally, only credit unions with an investment portfolio of a certain minimum size (circa €75m) should be permitted to invest in equities. A low allocation of between 5%-10% would not dramatically increase risk and allow credit unions to potentially add growth to portfolios and further diversify the investment book. Euro denominated Index tracking funds and ETFs would be our recommendation rather than single stocks. We believe there should be 2-tier investment guidelines rather than the current "one size fits all" approach.

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 welcome the addition of supranational bonds in the list of authorised classes of investments for credit unions.

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 would suggest the same concentration limits that are in place for Irish & EEA state securities and bank 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 welcome the potential to include corporate bonds in the list of authorised classes of investments for credit unions. A minimum long-term rating of A from at least 2 rating agencies is appropriate. We would propose the use of Euro-denominated index funds and ETFs for corporate bonds, to increase diversification and reduce risk.

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

We are in favour of the proposed limit of not exceeding 25% of the credit unions regulatory reserve.

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

We think that it is a good idea for Credit Unions to invest in Social Housing as an investment asset class. We are specifically referring to Social Housing projects/programs that are underpinned or underwritten by Government support mechanisms.

Therefore, we do think it is appropriate for credit unions to make investments in AHBs. Rationale: Diversification, potential returns higher than deposits, local community benefit, low risk (local authority/quasi government guarantee), non-correlation with current investment classes.

However, we believe the investment by Credit Unions into this sector should not be confined to AHB's only. The sector and asset class will benefit from having a range of investors which will create liquidity and competition with new funders from private equity and pension funds and thereby benefit all investors in the long run. Our primary concern from a risk assessment perspective is that the underlying investment has the same features above in that it is funded by a Government programme with long term support.

Although your paper refers to specific funding programmes another one that is likely to require investor support is the new Mortgage to Rent scheme announced by the Government in March 2017.

This is likely to see investment from Government funds, private equity, and combinations of same. The characteristics of this programme are broadly similar to the other programmes mentioned such as CALF and should be considered as a possible investment opportunity by Credit Unions also.

There will be investment opportunities that will suit the risk and return profile of Credit unions which match those of the AHB's and these should also be considered for potential investment opportunities by the Credit Unions.

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

We would support the proposals that a collective investment vehicle would be an appropriate structure, but would also like to see some flexibility to invest in this sector 1) through other channels as well as through AHB's 2) through other types of collective investment vehicle that may emerge, such as regulated fund type structures i.e. (QIAIFs & UCTISs) and publicly listed REITs (similar to Civitas Social Housing PLC which is listed on the London Stock Exchange).

Most of these investment vehicles could be appropriate and could be designed/modified (if at all necessary) to address MIFID considerations outlined in your paper and could be designed to provide a certain amount of liquidity given the long-term nature of this Social Housing sector which would be important for Credit Unions.

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?

The risks associated with Social Housing are the same as for any property related investment and specifically, development risk and then sales/income risk on that investment. We do not believe that Credit Unions should take on any development risk and this can be de risked by only investing in Social Housing assets that are built and completed.

On the second risk aspect, as long as the investment/assets are supported by a long-term income covenant from Local Authority/Government programme then that essentially eliminates a significant element of the risk and will be priced accordingly as a quasi-Government risk. As stated earlier we think this risk and investment profile is appropriate for Credit Unions.

The main risk surrounding this type of investment is the execution risk and the credit risk. What role will Government and/or local authorities play in standing behind the investment.

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

We refer to our earlier comments regarding the benefit of having several investors in this sector over time. This, as in any orderly market, will create opportunities for both long term and shorter-term investment periods. We would suggest that the creation of a broader investment market for funding, what is a very large and rapidly increasing Social Housing market, is both welcome and necessary and should benefit all investors and create more liquidity over time.

The Credit Union could also address some of the ALM issues by looking to take in longer term deposit and by some guaranteed mechanism in relation to exit from the investment.

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?

The limit agreed would have to be meaningful and regulatory guidelines in relation to fixed long term deposits would have to be amended.

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 welcome the proposal to include investments in Tier 3 AHBs in the list of authorised investments.

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 welcome the proposal to amend the existing counterparty limit for credit union investments from 25% to 20%.

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

We broadly agree with the proposed transitional arrangement – however if a credit union were to suffer a financial penalty in order to meet the 12-month transition deadline we would recommend an exception to be made on a case-by case basis.

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

We would like to see this remain as a permitted asset class. Particularly for index funds and ETFs where a credit union was allocating capital to corporate bonds for example. We believe that all permitted collective investment schemes should be regulated and listed on a recognised exchange.

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

Clear guidance on precisely what CIS can be used by credit unions would be helpful – currently the guidelines are too vague.

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.