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**28th June 2017**

**Registry of Credit Unions**
**Central Bank of Ireland**
**PO Box 559**
**College Green**
**Dublin 2**

Dear Sir or Madam,

**Consultation on Potential changes to the Investment Framework for Credit Unions**

I write to make submissions as part of the above consultation process.

**Bonds issued by supranational entities**

1. I agree with the CP109 proposals in respect of investing in these instruments in general, as well as the minimum credit rating, concentration and maturity limits proposed.

**Corporate bonds**

2. I agree with the CP109 proposals in respect of investing in these instruments in general, as well as the minimum credit rating, concentration and maturity limits proposed.

**Investments in AHBs**

3. I am strongly in favour of these proposals, which are appealing for the following reasons:
   a) The nature of social housing has a strong affinity with the social ethos of credit unions.
   b) The AHB sector has strong need for such funding and it is in the interests of both the sector itself and the State that that sector can access such funding without recourse to the State's balance sheet.
   c) As long as the Asset-Liability considerations are managed satisfactorily, the long-term nature of the investment adds resilience to credit union's income streams. The short-term nature of much credit union lending today exposes the sector's loan interest income streams to great and often painful volatility.
   d) The resilience of member savings throughout and since the recession demonstrates how suitable such funding is for long-term investment such as that required by AHBs.

4. I have worked closely with one long-established and large Tier 3 AHB over the past 12 months to explore how it could access credit union funding and that work has informed my views which follow.

5. Although these proposals are structured in terms of investments, the nature of credit union funding would be debt (or loan) investment. Therefore it is far closer to credit union's core lending business than investment activity much of which is either deposits with household name banks or in instruments that are either listed on an exchange, rated by a ratings agency, or both.

6. That said, the nature of such lending/investment will be complex and will demand considerable upskilling on the part of the credit unions, particularly those who have not previously issued commercial or community loans.

7. The AHB that I have been working with has a number of preferences in respect of its funding:
   a) It wishes to access single ticket funding per project i.e. if it is seeking funding for a particular social housing project it wishes the providers of its funding to aggregate into a very small number of borrowers, and preferable one borrower per project. It is able to obtain such funding on this basis today, from either the commercial banks or the Housing Finance Agency.
   b) It is prepared to offer the Payment & Availability Agreement as security.
   c) It is also prepared to offer a first charge over the premises as additional security.
   d) It would prefer the provision of such funding to be on a non-recourse basis i.e. each investor would have recourse only to its security s set out in b) and c) above rather than to the AHB itself. It has no appetite for full recourse funding from a variety of different suppliers, because of the inherent instability brought about by the possibility of one such supplier triggering a race to the Courts.
   e) Therefore the ring-fencing of all funding into different silos, each of which would be based around a particular housing project with default on one not impacting the others, is essential.
   f) Such ring fencing has great appeal to the credit union providing the funding because it can evaluate the merits of its investment on a project by project basis without having to assess broader and less visible risk arising from other projects or indeed the AHB itself.

8. CP109 asks the following question: *Do you think it is appropriate for credit unions to undertake investments in AHBs? If so, please provide a rationale.*

Yes, I do believe it is appropriate, for the reasons set out in 3 above.

9. CP109 asks the following question: *What would the most appropriate structure for investments in AHBs be e.g. investment vehicle?*

   A collective investment scheme is going to be costly and administratively burdensome, given all the various service providers that will need to be involved in its establishment, maintenance and operation. Furthermore, if a prospectus was required for every investment or investment tranche, the disclosure requirements of the Prospectus Directive would hinder true evaluation of the underlying risk.

   A far simpler mechanism would be for a single credit union to be the primary borrower, with the risk syndicated to other credit unions via a separate participation agreement through which the security passes through and without any recourse to the primary credit union borrower.

   Appropriate adjustment to the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 could provide a derogation from the regulations governing reserve requirements and loan concentration where such a suitable legal agreement passed all risk from the primary borrower credit union to other credit unions. This could be executed by the Central Bank without any need for primary legislation.

   This would require the primary credit union to have secondary credit unions *in situ* before or coterminous with its commitment to the initial risk.

   All subsequent interest and principal payments would be made simply from the AHB to the primary credit union which would pass it through to all secondary credit unions.

10. CP109 asks the following question: *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 nature of this risk is credit risk which credit unions are familiar with. However, in terms of likely parcel size, term, security and assessment of repayment capacity it will differ from their existing risk. Therefore, an upskilling will be required. This will be necessary whether mechanism is used to deliver AHB investment.

The impact on the credit union's balance sheet is assessed in 11 below.

11. CP109 asks the following question: *How can the ALM issues associated with such investments be addressed by credit unions?*

    ALM issues are already growing in credit unions, due to both growth on longer-term lending including mortgages and longer term investments as they hedge their future investment income. This is already exacerbating the natural Asset Liability mismatch inherent to any institution which transforms short-term savings into long term assets. I believe that the sector should (and in my experience some individual credit unions already are) seek(ing) to lengthen the liabilities side of their balance sheets to offset the lengthening of their assets. It might be useful for the Central Bank to encourage such structured Asset Liability management, particularly the term structure of the balance sheets.

12. CP109 asks the following question: *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?*

    CP88 imposed a concentration limit on corporate lending of 50% of regulatory reserves. The limit for AHB exposure should be at least this sum and given the strong affinity that social housing has with the social ethos of credit unions an argument can be made for 100% of regulatory reserves, particularly for credit unions that can demonstrate an expertise in AHB investment and appropriate Asset Liability Management techniques.

13. CP109 asks the following question: *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?*

None other than as stated above.

**Proposed reduction in counterparty limit to 20% per name**

14. I do not agree with this proposal. The number of banks which in a practical sense are available to credit unions has fallen sharply wince the first counterparty limits were introduced in October 2006 and with the recent withdrawal of Rabo from the market, this trend is continuing. Pressure on this limit has forced many credit unions to invest in structured credits which carried risks that they could not understand. Notwithstanding the elimination of many structured credit products in the CP88 regulations, these products continue to be offered to credit unions. Credit unions should be encouraged to avoid such risk rather than forced to take it on, even when they don't understand it. Reducing the counterparty limit forces them to take it on, which is counter to everything the Central Bank should be seeking to do.

Yours Sincerely

Robert T Moynihan