St. Ailbe's Credit Union Limited

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Central Bank of Ireland

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Submission on CP109

1. Background

St.Ailbe's Credit Union was established in 1980 in response to the economic situation in the community area at the time. Its purpose was to lend to the 'working person' when they found impossible to borrow elsewhere.

This member-owned, not-for-profit financial cooperative is dedicated to providing its members with quality financial services and products through a continuous upgrading of our information technology services and an enhanced personal delivery of services through our five offices (Caherconlish, Cappamore, Hospital, Ballyneety and Pallasgreen). SACU have successfully serviced the community for 36 years and have been the proud supporters and sponsors of many local clubs, organisations, charities and events.

2. Introduction

On 11 May 2017, the Central Bank published a Consultation Paper CP 109 on Potential Changes to the Investment Framework for Credit Unions. St.Ailbe's Credit Union welcomes the opportunity to respond to this and to address within this document significant issues which arise from the proposed changes.

Investment portfolio management is a key focus for the Board and we have continued to engage with an experienced external consultant in managing the investment portfolio. The investment yield has declined from approximately 100-200bps in the past 2 years. This has a significant impact the on Credit Union's Profit & Loss. Our expectation for investment income return for 2017 is as low as 0.01%. To ensure the ongoing viability of our community credit union, we are keen to assess all avenues in generating return on our investments while maintaining an acceptable risk appetite in safeguarding members deposits.

3. Responses to the Central Bank's Questions

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 agree with the Central Bank that credit union investment portfolios are too concentrated. At present, credit unions have little choice other than to consider cash deposits or bank bonds. Restrictive investment classes are a challenge in managing investment return.

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 inclusion of additional investment classes. We agree with the proposal to include supranational bonds and corporate bonds but note that they will have a negligible impact on our investment income. The key vulnerability for the business model of most credit unions is the ability to generate an adequate investment return on members savings and these additional investment classes do very little to address this significant challenge.

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.

Yes, in agreement with ILCU and in conjunction with the ethos of the credit union, we ask the Central Bank to consider including the following as additional investment classes:

- Centralised Mortgage Lending
- Centralised SME Lending
- Equites

- State Sponsored Projects
- UCITS reinstated

Centralised Mortgage Lending

The ILCU Home Loan Working Group which was set up by the ILCU Board comprising representatives from the ILCU, supported by appropriate external expertise has recommended the implementation of a shared services model and central support mechanism so that credit unions can offer home loans in a prudent and compliant manner underpinned by a robust standardised process. St.Ailbe's Credit Union would hope to avail of this investment opportunity.

Centralised SME Lending

Credit Unions as community based lending organisations have a wider economic and social mission than solely providing financial services and are therefore ideally positioned to extend loans to local enterprises, thereby contribution to generation of local employment with consequent benefits of economic development. St.Ailbe's Credit Union would support the concept of a centralised SPV that would facilitate a stronger risk management capability but still allow us to offer lending to our local SMEs.

UCITS

We would recommend the reinstatement of Undertakings for Collective Investment in Transferable Securities. This would contribute to the diversification of the Investment portfolio as well as offering the potential to achieve a higher yield on investments.

Bank Bonds

We have serious concerns around the proposed amendment to the definition of Bank Bonds; 'that bonds that are subordinated to any senior bonds issued by a credit institution do not fall within the definition of "bank bonds". This could have a material impact on the potential yield on our investments. The credit risk associated with such bonds may not be any greater than risk than those of a bond that is not subordinated. We would recommend a minimum credit rating of Investment Grade to be applied to Bank Bonds instead.

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?

St.Ailbe's welcomes the potential additional investment asset classes. We do understand, however that the yields on these bonds are very low and are effectively similar to Government Bonds. We suggest that the minimum credit rating requirement and maturity limit be kept consistent with the existing 2016 Regulations in relation to existing investment asset classes.

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 oppose the introduction of regulatory reserves as a concentration limit. We propose that the concentration limits on supranational bonds is incorporated into the current asset class level of 70%.

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?

St.Ailbe's acknowledges that the potential addition of Corporate Bonds to the investment asset classes will provide us with an opportunity to allocate a portion of investment portfolios to non-financial counterparties whose performance is not correlated to that of credit unions of the broader financial sector. However, yields on "A" rated Corporate Bonds currently offer very low investment return upside to credit unions.
We would ask the Central Bank to consider a minimum credit rating of investment Grade being applied for Corporate Bonds invested in a Collective Investment Scheme.
We concur with the proposed maturity limit of 10 years to be applied in respect of Corporate Bonds.

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 proposes that the concentration limit of corporate bonds is incorporated into the current 70% asset class limit of bank bonds.

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

Credit unions are a natural investor in social housing.
Appropriate vehicles must be put in place to make credit unions' investment in social housing meaningful, affordable to credit unions and affordable by housing applicants.

9. What would the most appropriate structure for investments in AHBs be e.g. investment vehicle?
We feel that special purpose vehicles (SPVs) or collective investment schemes are potentially the most appropriate structures for investments in AHBs.

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 key risks associated with this type of investment is counterparty credit risk, liquidity risk and investment risk. We also recognise other risks such as development risk, regulatory risk and interest rate risk.
There is as assessment set out in the ILCU response to the AHBs ability to repay the money borrowed which underpins the key risks. The conclusion being the primary responsibility to repay the loan is the State.

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

While the investments in these SPVs by nature would be longer term investments, we expect that the central management of the SPV would create a balance in the portfolio in terms of length of term within a mix of projects addressing some potential liquidity issues and we would also manage our short term liquidity appropriately.

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 would not recommend a very restrictive concentration level (>10%) but would be initially prudent in the internal investment policy we adopt until we can review the success of the initiative.

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?

For an investment in social housing to be tenable we accept that a term of up to 25 years will be required.

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 do not feel it is appropriate to reduce the counterparty limit for credit union investments at this time. Diversification proposals in CP109 are insufficient to warrant any contraction in current limits.

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

We would propose a 24-month transitional period but believe that the matter of a transitional period should not arise.

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

We would advocate the use of collective investment schemes for credit unions investments.

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

The most dominant barrier currently is on the supply side. Under the current allowable definition, these type of schemes are not available and would be too costly to create, manage and administer with yields where they are.

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 believe there are quite a few issues to be discussed, resolved and agreed upon prior to a timeline being imposed. However, we do note that the most challenging investment environment is present and positive implications for increasing investment yield should be implemented sooner rather than later.

Marie Keating (Hon Sec)
St Ailbe's Credit Union Limited