To: rcuconsultation@centralbank.ie

"Consultation on Potential Changes to the Investment Framework for Credit Unions"

Tipperary Credit Union Limited Submission

Date: 20th June 2017

Managing Investment Risk

Tipperary Credit Union Limited (TCU) welcomes the Central Bank's continued focus on the protection of Member's Savings and that the risk profile of credit union investment portfolios should reflect this requirement.

The Central Bank is very much aware of the low returns that appropriate investment portfolios are generating, especially in the current low interest rate environment, or will be able to generate in the foreseeable future. They have the information and realise the impact of concentrating on the protection of member savings can have on investment returns going forward. They say that their "overriding consideration in setting investment regulations must be their statutory mandate to regulate and supervise credit unions with a view to ensuring the protection by credit unions of the funds of its members' and the maintenance of the financial stability and well-being of credit unions generally".

Tipperary Credit Union Concerns

Tipperary Credit Union accepts that the protection of member savings is paramount. This is achieved in Credit Unions, not only by prudent investment management in capital guaranteed products but also by good loan underwriting practices and procedures; good governance, compliance and risk management processes; and the achievement of a sufficient annual surplus to cover costs, pay a modest dividend and build up reserves for the future. The protection of member savings is not just down to investment decisions. Credit Unions have to make a surplus and maintain reserves in order to survive.

Current negligible and minus investment yields, coupled with falling loan books and rising costs, are putting the survival of many credit unions into question. TCU accepts that prudent investment decisions have to be made in low risk investment products. However it holds the view that there has to be a trade-off between risk and reward. It accepts that the protection of member savings is paramount but a significant fall-off in Investment Income will also create a serious risk to credit unions – lower surplus; losses; low or no dividend; reduced reserves; loss of confidence; financial instability.

TCU accepts that some of the proposed investment changes in CP109 do strengthen the risk profile in Credit Unions. However, it is concerned that some of the proposed changes actually increase risk and will put further stains on a credit union to operate successfully. These issues are explored below.

CP 109 Proposed changes and TCU comments

Liquidity

Section 43 of the Credit Union Act 1997 requires, inter alia, that a credit union, before making an investment decision, shall assess the impact on the liquidity and financial position of the credit union. CP 109, however, is silent on the issue of 'liquidity' in credit unions and does not propose any changes to the existing Section 35 liquidity requirements**. Tipperary Credit Union requests the Central Bank to change current Liquidity requirements and allow Bank Bonds, Governments Gilts and Supranational Bonds be used in the short term liquidity calculations. This would allow existing short-term deposits held in Credit Unions (which are currently attracting negative yields of up to 1%) be invested for longer terms, with the potential of a modest return being made. Thus a 'risk and reward' strategy would be maintained.**

Liquidity Example

Assuming a credit union has the approved 40% loans over five year 'extension limit', under S 35, it must maintain **a liquidity requirement of 30%** of its unattached savings. The Credit Union must hold **30%** of its unattached savings in investments with a maturity of 90 days or less, of which, **5%** must be held in investments with a maturity of 7 days or less. Taking a Credit Union with Gross Assets of €150 million, Investments of €100 million, Savings of €125 million and unattached savings of €100 million, then a typical scenario would apply

Ref	Investment Type	Amount €	Average Yield / Return	Expected Annual Income / (Loss)
A	Less than 8 day Deposits (5% of Unattached Savings)	5,000,000	-0.3%	-€15,000
B	Less than 90 day Deposits (25% of unattached savings)	25,000,000	-0.4%	-€100,000
C	Greater than 90 day Deposits	40,000,000	1.5%	€600,000
D	Bank Bonds	10,000,000	1.2%	€120,000
E	Government Gilts	20,000,000	4.0%	€800,000
F	Collective Investment Schemes	0	0%	€0
	Total Investments	**100,000,000**	**1.41%**	**€1,405,000**

In the above example.

- **€30,000,000** (Ref A & B above) is required, for liquidity purposes, to be held in 90 day deposits, or less. Currently, there are no returns available on these short term deposits. Indeed, some banks are actually offering negative rates (BOI offering minus 0.8% for 3 month deposits). This Credit Union is currently **incurring losses of €115,000** per annum on these investments.

- **€30,000,000** (Ref D & E) is held by this Credit Union, in Bank Bonds and Governments Gilts - Currently giving an annual return of €920,000.
- **Under current S 35 rules**, the €30 million held in Bank Bonds and Gilts cannot be used in the short-term liquidity calculation, even though they are highly liquid products.
- The Bank Bonds and Gilts are accounted for using the FRS 102 rules. Credit Unions are prepared to value these investments on a mark-to-market basis if required.
- **Allowing the €30 million investments (D & E above) held in Bank Bonds and Gilts be used for short-term liquidity purposes would allow this Credit Union invest its current short-term Investments (€30 million above) for longer terms. Assume, Five Year Deposit Rate is 0.3%, then this would give EXTRA annual investment income of €90,000. (€30 million by 0.3%). We would also avoid incurring annual losses of €115,000 on the existing short term deposits.**
- The risk will not have changed and the reward is better.

Concentration Limits

Current concentration limit is a maximum of 25% invested with any one institution. **TCU agrees with the revised 20% limit.** This would reduce investment risk, especially in light of the 'bail-in' implications, if an individual financial institution failed.

Subordinated Debt

TCU agrees that Credit Unions should not be permitted to invest in subordinated debt instruments. However, it requests that subordinated bonds it currently holds [redacted] be allowed to be kept to maturity, and clarification communicated on this issue.

Bonds issued by Supranational Entities

- TCU welcomes this potential new investment class. However, it expects returns will be zero or minus and unlikely to rise in the short to medium term.
- TCU feels that the 50% of Regulatory Reserve limit is too restrictive for these extremely low risk products, and the investment ratio should be **increased to 75% of the Regulatory Reserve.**
- TCU requests that the Central Bank allow investments in supranational entities and products be **treated as liquid funds in the S 35 liquidity calculations**. These funds are very low risk and highly liquid.

Corporate Bonds

TCU welcomes this potential new investment class. However it has some concerns and feels that these investment could potentially result in increased risk

- Credit Unions will require specialist advice on these products, both at initial purchase decision stage and on an on-going basis. These products will be sold to Credit Unions through the main brokers – Davy, Goodbody, Cantor, Merrion, etc. The same companies will

also be offering advice to Credit Unions. Thus a potential conflict of interest exists and TCU is concerned that there are no obvious independent advisors who can currently give independent advice to the movement.

- Also, if Credit Unions invest in Corporate Bonds, they will need to monitor on an on-going basis, how the Company, whose bond they have invested in, is performing. Many external and macro-economic factors affect a company's performance (e.g., potential effect of BREXIT). TCU is concerned that the Credit Union movement does not have the specific skills or expertise in this area.
- Notwithstanding the above concerns, **TCU fees that the investment limit of 25% of Regulatory Reserves in Corporate Bonds is too low, and should be increased to 50% of Regulatory Reserve.** Investment in Corporate Bonds is the one area that a Credit Union would make a potential decent return, assuming all risks have been assessed and independent advice received, both at purchase stage and on an on-going basis.

Investment in Tier 3 Approved Housing Bodies (AHBs)

TCU does not believe that Credit Unions should get involved in AHBs at this point in time.

- They are potentially high risk investments.
- Many housing agencies have poor compliance and risk management processes. It is likely that a regulatory authority (such as the HSA, HIQUA) will become more pro-actively involved in many of these bodies in the near future. This will result in increased compliance costs and increased financial pressure.
- Many AHBs receive guaranteed rent payments from local authorities. However, many don't, and rely on rent-rolls from private tenants. Courts are very reluctant to evict tenants from AHB properties where arrears exist, and will not entertain re-possession orders, to any great extent. Thus, many AHBs may end up in financial trouble. This would pose a major risk to a credit union who had invested in a financially stressed Housing Body.
- Tipperary Credit Union feels that Credit Unions **could lend** to local authorities or AHBs, and take security of assets – i.e., asset-backed lending, plus ability to repay, guaranteed payments for government or local authority.

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Secretary

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