Youghal
CREDIT UNION LTD

Registry of Credit Unions
Central Bank of Ireland
PO Box 559
New Wapping Street
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Dublin 1

27th June 2017

Dear Sir or Madam,

Please find attached the responses from Youghal Credit Union ("YCU") to the Central Banks questions on CP109 – Consultation on potential changes to the investment framework for Credit Unions.

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. The current choices are not broad enough and are resulting in limited choices other than the underperforming deposits and bank bonds. If the framework was more flexible, it may allow us to free up the cash currently on negative interest and use it for greater good in Ireland. An example of potential use would be for social housing or as a PPP for infrastructure projects around Ireland.

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 agree with the proposal to include supranational bonds and corporate bonds. However, the suggested investment classes add little to the Credit Unions reinvestment challenge, given the suggested restrictions in the maximum percentage of investments that will be available for consideration.

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. The RCU should allow credit unions to assess investments and decide if they are suitable and based on their own investment objectives. We would also include potential investments in the following areas:

- Investment in senior bank bonds
- Investment in Social Housing projects
- Investment in Public Private Partnerships (PPP) for development of infrastructure in Ireland (i.e. Road network)
- Investment in Semi-State companies
- Investment in passive indexed funds

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?

YCU agrees with this proposal, together with proposed minimum credit rating and maturity limit.

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. YCU proposes 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?

YCU agrees with this proposal, together with proposed minimum credit rating and maturity limit. An alternative to this would be to use the more stable and cheaper alternative of passive indexed funds.

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.

YCU proposes that the concentration limits on supranational bonds is incorporated into the current asset class level of 70%.

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.

The specifics of the investment risk however are unclear from such a proposal. In general terms, without visibility on a specific proposal, it is hard to recommend investing in long term funds (up to 25 years), where there is no visibility on returns, no indication on the default risks in real and nominal terms and no clarity on the underlying exposure.

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. We recommend that the Central Bank opens an application process that accepts proposals with assessments conducted on a case by case basis.

We believe it is important to be done centrally as some of the Common Bonds will not have Tier 3 AHB to invest in so will not get the benefit if this investment. Reversely, some Commons Bonds will have a lot of Tier 3 AHB to invest in and not sufficient capital in the Credit Union to fund it.

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?

Risks associated with investing in this sector may be summarised as, liquidity risk, investment risk, regulatory risk, financial risk and business model risk. There is also the risk of Credit Unions competing to fund AHB projects in certain counties. This could lead to a race to the bottom type scenario.

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

YCU believes that the only realistic way of dealing with the ALM issues arising from investments in AHBs is to provide the investment through a collective investment vehicle which is large and accessible to all credit unions or via a bond mechanism where the credit union can buy the bonds directly from the AHBs to help fund their projects..

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 recommend a concentration limit of 5% initially to be reviewed for potential upward revision as the sector develops over the next few years. Creating an explicit ALM match for credit unions is problematic. We see the duration of AHB investments as remaining an outlier in ALM terms as it is not possible in our view to duration match AHB investments and the loan book of credit unions. Rather, investment in AHBs needs to be looked at on a portfolio basis and in this context, a 5% weighting will not pose a significant risk in ALM terms, as the overall investment portfolio duration remains relatively short.

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 may be required. We believe that there may be other options worthy of consideration:

- Development between credit unions and the NTMA to use their expertise
- Examination of the market models used in other countries
- A tiered approached to investment (5/10/20/25 year investments)
- Guarantees on liquidity invested from Government
- Consideration for other Tiers AHB should be considered
- Potential for AHBs to issue bonds for credit unions to purchase (same as sovereign or bank bonds)

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 would not support an amendment to the current limits at this time. European banking institutions are currently exiting the domestic Irish banking market. Irish domestic banks are currently pricing away non-bank financial intermediary deposits and in the current environment credit unions are already struggling to preserve capital with negative interest rates being applied by many domestic and most European deposit providers.

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

We are not of the view that the introduction of this measure is appropriate at this time. The market is not in a position where credit unions have the choice to move around freely. Reducing the limit would only worsen this position.

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

YCU advocates the use of collective investment schemes for credit unions in certain circumstances. This would only be a benefit if the costs of having a collective investment scheme were lower than the additional incomes from being part of the scheme. If we take the example of deposits or bank bonds, the credit union can capture higher returns by placing or holding these investment instruments directly.

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

We believe there are a number of barriers to using these schemes:

- The returns available in the types of investment that lend themselves to a collective investment scheme type structure are currently too small.
- The returns do not justify the costs associated with the establishment and running of such structures and the liquidity requirements associated with running these structures.
- Under FRS 102, collective investment schemes must be valued at fair value. Many credit unions hold a preference for valuing investments on an amortised cost basis and are therefore reluctant to absorb the mark to market volatility of collective investment schemes.
- Authorisation process in the Central Bank may represent a barrier for advisers.

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 welcome the additional categories such as supranational bonds, corporate bonds and AHBs introduced as soon as possible. As outlined above, we believe that any reduction of counterparty exposure limits in the absence of more domestically available deposit providers should not be considered at this time.

We would have welcomed further discussion in the areas of Liquidity and income, given they are our key KPIs, whilst discussing this area. Liquidity is key for all credit unions and asking to invest for 25 years in AHBs requires a serious discussion on liquidity for the credit union. Also, we only use investments to generate income for our members. If the alternative investments as discussed in this proposal do not help increase our income, then I would question the need to have this discussion. Therefore, it is important we discuss liquidity and investment return as part of this conversation.

The restriction of senior bank bonds is also a worry. This is a large part of our income from investments and if this was to be restricted, then we would be taking two steps back and one step forward in this proposal. It is imperative that we keep this type of investment and add to our options of investments in order to improve our investment return and diversify our investment portfolio.

Please contact us if you wish for us to discuss this further.

Yours Sincerely,

Youghal Credit Union