March 2014

GlobalReach Securities

GlobalReach Securities Limited

Submission on Consultation Paper CP 76 on the Introduction of a Tiered Regulatory Approach for Credit Unions

Introduction

GlobalReach Securities Ltd are independent investment advisors to 50 credit unions who between them have total investments of €1.8bn. We would like to take this opportunity to put forward our views on CP 76, focusing specifically on the proposals relating to investments (Section 5.2) and liquidity (Section 5.10).

In an environment where credit unions must be increasingly conscious of investment risk to ensure the security of members' savings, we believe that proper investment management is more important than ever, particularly as investments now constitute almost 70% of total assets in the credit union sector.

Investment management best practice ensures that there is never an over-concentration of risk in terms of counterparty, market, investment class etc., but that an investment portfolio is as diversified as reasonably possible. In that regard we believe that certain proposals in CP 76 are positive moves in the right direction, but that others would be counterproductive.

Investment Classes & Limits (Section 5.3.1)

We address the proposals in this section under 3 headings:

(a) Counterparty Limits
(b) Investment Classes
(c) Maturity Limits

(a) Counterparty Limits

We welcome the suggestion to apply a counterparty limit based on each credit union's regulatory reserve, as it is more appropriate and relevant than the current 25% portfolio limit. For the vast majority of credit unions it will mean a lowering of the counterparty limit and therefore a requirement to use a greater number of counterparties. (Among the credit unions we advise, the regulatory reserve is on average equal to 17.3% of the investment portfolio). While this may reduce the income that a credit union earns from its investments, we believe that increased diversification is consistent with best practice.

(b) Investment Classes

Credit unions can currently invest in five investment classes, but under these proposals this will be reduced to two for Category 1 credit unions.

We understand the exclusion of equities as an investment class, as we believe that the nature of those investments is such that they involve a level of volatility and risk that is not appropriate for credit unions.

Bank Bonds

Bank bonds, on the other hand, have been an important investment class for most credit unions, and we do not understand their exclusion. At a time when there is an ever-decreasing number of banks operating in the Irish deposit market, bank bonds offer an opportunity to spread investments among a wider range of counterparties than would otherwise be the case.

We note that Category 2 credit unions will not only continue to be able to invest in bank bonds, but will also be allowed to invest in other corporate bonds. This would seem to be recognition of the benefits of diversifying among a greater range of investments and counterparties, and we welcome this change. But in our opinion, it is inconsistent to allow a broader range of investments for one group of credit unions while narrowing the range for others.

We believe that the removal of bank bonds as an investment class would significantly curtail a credit union's ability to diversify its counterparties and would be a counterproductive step. We would suggest that this be reconsidered. If there is a concern that credit unions might invest in bank bonds that involve excessive risk, a minimum credit rating of A could be applied.

It is proposed that Category 2 credit unions will still be permitted to invest in bank bonds (subject to much lower limits than currently allowed), but in that regard the document specifically refers to senior unsecured bonds. That is presumably designed to exclude subordinated bonds, but would also exclude secured or covered bonds which are higher rated and more secure than senior unsecured bonds. In our opinion it does not make sense to permit senior unsecured bonds and to exclude secured or covered bonds.

Collective Investment Schemes

Collective investment schemes have also been very useful vehicles for diversification within a portfolio, while providing instant liquidity and a reasonable return. Given the greater need for diversification, the growing challenge to earn income, and the proposed new liquidity requirements, collective investment schemes would be more relevant and beneficial to a credit union investment portfolios than ever before.

As regulated vehicles managed by experienced professionals, collective investment schemes are in many ways ideally suited to credit unions, particularly smaller credit unions who do not have the expertise to manage their investments or the resources to pay for such expertise.

Assuming that the underlying assets within any such collective investment scheme would continue to be subject to the definitions and limits of the other investment classes, there would be no question of it adding to the risk within a portfolio. On the contrary, it would provide an opportunity for better management and diversification of risk than would be available via any other investment class.

(c) Maturity Limits

We believe that the 5 year maturity limit for Category 1 credit unions would be very restrictive in terms of a credit union's ability to have a consistent spread of investment maturities in line with best industry practice. It would also undoubtedly impact the investment income earned by a credit union, particularly during this period of historically low interest rates.

Longer term investments not only allow a credit union earn higher returns, but also protects the future income on that portion of the investment portfolio. This is consistent with ensuring the long term financial health and viability of the organization.

We suggest that it would be more appropriate to have maturity limits along similar lines to those applied to credit union loan books. For example, up to 20% of the investment portfolio could be in investments with maturities between 5 and 10 years.

Liquidity (Section 5.10)

We understand the rationale behind the proposed introduction of 7 day and 1 month liquidity requirements, but would make the observation that it will present further challenges to credit unions in terms of investment income. The exclusion of collective investment schemes will exacerbate this problem as they have been an important source of liquidity in the past, while providing reasonable rates of return. Under these proposals, more of the investment portfolio will need to be held in call deposits which generally earn very low returns.

Summary

GlobalReach welcomes many of the proposals relating to investments in CP 76, but there are two in particular which we believe are contrary to investment management best practice, namely:

1. The proposal to permit Category 1 credit unions to invest only in bank deposits and Irish & EEA state securities, and in particular the exclusion of bank bonds and collective investment schemes.

2. The proposal to restrict Category 1 credit union investments to no longer than 5 years.

We believe that not only will those proposals make it more difficult for credit unions to ensure their long term financial health and viability, but we believe that they are contrary to best practice in terms of managing investment risk. We would urge you to reconsider those proposals.

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