Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Feedback Statement on CP109 – Consultation on Potential Changes to the Investment Framework for Credit Unions

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Foreword

The Central Bank undertook a review of the existing investment regulations in 2017 to consider whether it is appropriate and prudent to facilitate investment by credit unions in other classes of investments. CP109 set out our proposed changes to the investment framework for credit unions and invited feedback on these proposals.

I would like to take this opportunity, on the publication of the revised regulations for credit unions and the feedback statement on CP109, to acknowledge the level of interest in these regulations and to thank all those who have provided feedback on the Central Bank's proposals.

The Central Bank acknowledges the important role which credit unions play in Irish society and in the financial system, and the strong voluntary and community ethos of the sector. Both the role and ethos reflect the primary objects and purpose of credit unions to promote thrift among their members by the accumulation of their savings and the creation of sources of credit for members' mutual benefit at fair and reasonable interest rates. Our statutory mandate is to ensure the protection by each credit union of the funds of its members, and to maintain the financial stability and well-being of credit unions generally. This informs our approach to all aspects of the regulatory framework for credit unions, including the investment framework.

The Central Bank remains of the view that any changes to the investment framework for credit unions should reflect the fact that it is the savings of credit union members (which can be withdrawn on demand) that will be invested by credit unions and that the risk profile of credit union investment portfolios should reflect this. We acknowledge that this will necessarily impact on the level of return that appropriate investment portfolios can generate. However, we are strongly of the view that lending and the provision of services to members should be the key drivers of sector viability and that it is therefore not appropriate to seek to calibrate the investment framework to drive returns.

In recognition of this, we established a new unit in 2016 with a mandate to engage with credit unions on business model changes in order to progress well-developed proposals supported by credible risk-focused business plans. We will also be undertaking a review of longer term lending limits in 2018 with a view to supporting prudent lending opportunities for credit unions.

The Central Bank has given detailed consideration to the submissions received on the proposals set out in CP109 and this feedback has influenced the approach in areas such as:

- *Concentration limits for new classes of investments;*

- *The application of liquidity requirements; and*
- *Transitional arrangements for the revised counterparty limit.*

These regulations introduce important changes to the investment framework for credit unions with the introduction of three additional classes of investments which will facilitate increased levels of diversification in credit union investment portfolios.

The changes being made with the introduction of these revised regulations demonstrate the flexibility provided by the provision of regulation making powers to the Central Bank. The sector brought forward detailed proposals around the provision of funding by credit unions to approved housing bodies to facilitate social housing and following comprehensive engagement and consultation credit union regulations now allow for credit unions to provide funding to support the provision of social housing.

The Central Bank will continue to review and update regulations as appropriate following consultation. The Central Bank is keen to ensure that regulations remain appropriate for the credit union sector and in the future, and where credit unions set out a clear path on how they wish to develop, we will consider any amendments to the regulations that may be appropriate to facilitate such development.

Patrick Casey

Registrar of Credit Unions

1. Introduction

Following a review of the investment framework for credit unions, the Central Bank published CP109 "Consultation on Potential Changes to the Investment Framework for Credit Unions" (CP109) on 11 May 2017. CP109 set out potential changes to the investment framework for credit unions, along with a Regulatory Impact Analysis (RIA), and sought views from credit unions and other sector stakeholders on the potential changes outlined, together with feedback as to whether there are additional investment classes appropriate for credit unions taking account of the appropriate risk profile for such investments. CP109 posed 18 specific questions for respondents to address. The closing date for submissions was 28 June 2017.

74 submissions were received in response to CP109. The Central Bank would like to thank all parties who took the time to make a submission on CP109 to inform the policy development process. The submissions received can be broken down as follows:

- 58 from individual credit unions;
- 3 from credit union bodies;
- 5 from investment firms; and
- 8 from others (including professional bodies, TD's and Approved Housing Bodies (AHBs) stakeholders).

All submissions received are available on the Central Bank website at the following link. Following completion of the consultation on CP109 and consideration of the submissions received, in line with section 84A of the Credit Union Act, 1997 (the 1997 Act), the Central Bank has consulted with the Minister for Finance and the Credit Union Advisory Committee (CUAC). The Central Bank also further consulted with credit union bodies at that time.

This paper summarises the feedback received on CP109 and sets out the Central Bank's considered decisions. It is intended to be read in conjunction with CP109 and makes reference to proposals and terms used in the original consultation document, which can be found on the Central Bank's website at the following link.

Section 2 of this feedback statement provides a high level summary of the proposals set out in CP109, the feedback received and the Central Bank's response to this feedback. Section 3 provides details on the proposals set out and questions posed in CP109 along with a summary of the feedback received on each question posed in CP109 and the Central Bank's response. Section 4 of this feedback statement provides an overview of additional feedback received and the Central Bank's response to this feedback. The final section, Section 5, of this feedback statement provides details on the statutory consultation conducted in line with section 84A of the 1997 Act. The amending regulations for the investments and liquidity framework are set out in Appendix 1. Comparison tables outlining the differences between the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (the 2016 Regulations) and the amending regulations on investments and liquidity can be found in Appendix 2.

This feedback statement is published to promote understanding of the policy formation process within the Central Bank and is for information purposes only. This document does not alter legal or regulatory requirements for credit unions. This document does not constitute legal advice and should not be used as a substitute for such advice. It is the responsibility of all credit unions to ensure their compliance with legal and regulatory requirements.

As indicated in the RIA which accompanied CP109, the Central Bank will undertake and publish analysis of credit union sector investments, two years post commencement of the amending investment regulations for credit unions, to assess and analyse the actual impact which the changes to the investment regulations have had.

2. Executive Summary

Review of Investment Framework for Credit unions

In order to ensure that the investment regulations remain appropriate for the credit union sector, the Central Bank undertook to review the investment regulations in 2017 to consider whether it is appropriate and prudent, at this stage, to facilitate investment by credit unions in other classes of investments.

The review was undertaken in the context of:

- the Central Bank's statutory mandate to regulate and supervise credit unions with a view to ensuring the protection by each credit union of the funds of its members and the maintenance of the financial stability and well-being of credit unions generally;
- the objects of credit unions set out in the 1997 Act;
- the legislative requirement, set out in section 43 of the 1997 Act, for credit unions to ensure investments do not involve undue risk to members' savings;
- the existing makeup of sector investments (including observed trends over the past five years);
- proposals being brought forward by the sector; and
- changes to the investment environment arising from the Banking Recovery and Resolution Directive (BRRD).

Consultation on Potential Changes to the Investment Framework for Credit Unions

Following a review of the investment framework for credit unions, the Central Bank published CP109 "Consultation on Potential Changes to the Investment Framework for Credit Unions" (CP109) on 11 May 2017. CP109 set out potential changes to the investment framework for credit unions, along with a Regulatory Impact Analysis (RIA), and sought views from credit unions and other sector stakeholders on the potential changes outlined.

CP109 indicated that the Central Bank is considering the following potential additional investment classes for credit unions which would be accompanied by the introduction of specified credit quality, maturity and concentration limits:

- Bonds issued by Supranational Entities;
- Corporate Bonds; and
- Investments in Tier 3 AHBs[1].

CP109 set out information on the impact of BRRD for credit union investments and articulated the Central Bank's view that it is not appropriate for credit unions to invest in debt instruments that are subordinated to senior liabilities issued by the same credit institution and thereby eligible for MREL (Minimum Requirements for Own Funds and Eligible Liabilities).

CP109 also set out proposals to reduce the existing investment counterparty limit from 25% to 20% of total investments and sought feedback on the use of collective investment

[1] The regulatory code applied to AHBs divides AHBs into three tiers – Tier 3 refers to larger AHBs.

schemes and any barriers to credit unions using collective investment schemes within the existing investment framework.

Feedback Received

Feedback received is broadly supportive of the proposals to introduce additional classes of investments for credit unions. However, while respondents recognise the diversification benefits of additional classes of investments, many express concerns that the proposals would not provide credit unions with opportunities to enhance investment returns in the current interest rate environment.

A large number of submissions raise concerns around the proposal to reduce the counterparty limit from 25% to 20% of total investments citing the challenge presented by the withdrawal of counterparties from the credit union market and the potential reduction in availability of eligible senior bank bonds as barriers to meeting a reduced counterparty limit.

In addition to this feedback which relates to specific questions posed in CP109, respondents also provide significant feedback on bank bonds and existing liquidity requirements for credit unions.

Bank bonds

Many submissions raise concerns on the implications of the Central Bank's position that it is appropriate that credit unions would not be permitted to invest in subordinated debt instruments that are eligible for MREL, given their risk profile and the potential implications for credit unions should the institutions that issued the instrument enter into resolution. Feedback provided indicates that the Central Bank's position would effectively close off the investment class of bank bonds to credit unions as institutions are likely to focus on issuance of subordinated debt instruments that are eligible for MREL, limiting the availability of eligible senior bank bonds for credit unions. Respondents express concerns about the impact that this would have on credit unions' ability to generate income from their investment portfolios.

Liquidity

Submissions also highlight challenges credit unions face in relation to meeting existing liquidity requirements. Feedback provided notes the low and negative rates currently being paid on short term deposits held by credit unions and indicates that some counterparties are no longer accepting short term deposits from credit unions. Expanding the definition of liquid assets to include certain bonds is put forward as a suggestion in a number of submissions.

Central Bank Response

The Central Bank has given detailed consideration to the submissions received and the feedback has influenced our approach in areas such as the:

- concentration and credit quality limits for proposed additional classes of investments;
- liquidity requirements; and
- transitional arrangements for the revised counterparty limit.

Concentration and Credit Quality Limits

Having considered the feedback received, the Central Bank is making a number of changes to the concentration limits proposed in CP109. These changes provide for the inclusion of supranational bonds in the concentration limit currently applying to

government bonds[2] which will provide additional flexibility for credit unions to invest in these bonds. Additionally, the concentration limit for investments in corporate bonds has been increased to 50% of regulatory reserves.

In relation to investments in AHBs, a tiered concentration limit is being applied to investments in AHBs which will facilitate larger investments by credit unions with total assets of over €100m.

Having considered feedback in relation to investments in corporate bonds, the Central Bank has changed the minimum credit rating for investment in corporate bonds through an Undertaking for Collective Investment in Transferrable Securities (UCITS) from a rating of A to investment grade, in acknowledgement of the diversification opportunities that this may provide for credit unions and has also introduced an additional counterparty limit where investment is undertaken directly in corporate bonds.

Bank bonds

The Central Bank remains of the view that it is appropriate that credit unions would **not** be permitted to invest in debt instruments that are subordinated to senior liabilities issued by the same credit institution, given their complexity and risk profile and the potential implications for credit unions should the instrument be written down or converted into equity.

We are of the view that a number of the proposed changes set out in this feedback statement will address some of the concerns raised in submissions in relation to the proposed amendment to the definition of bank bonds. These include the changes, referred to above, in the concentration limit for supranational and corporate bonds and the changes being made to liquidity requirements which may help to encourage further diversification in credit union investment portfolios.

Liquidity

In light of the submissions received on liquidity, the Central Bank undertook analysis on the liquidity position of credit unions with a view to better understanding how the liquidity requirements are impacting on individual credit unions and the sector more broadly – details on this analysis is set out in section 4.2.

Having considered the feedback received and the additional analysis undertaken by the Central Bank, we have decided to introduce a number of amendments to the existing liquidity requirements. These changes will broaden the definition of liquid assets, allowing credit unions to include certain bonds when calculating liquidity subject to applicable discounts and will reduce the short term liquidity requirement from 5% to 2.5% of unattached savings. The Central Bank believes that this may help to encourage increased levels of diversification in credit union investment portfolios and a more proactive approach to liquidity management.

Further details on feedback received and the Central Bank's response to this feedback is set out in sections 3 and 4 of this feedback statement.

Where there is financial data presented and analysis undertaken throughout this feedback statement, this is based on financial data submitted by individual credit unions on the 30 June 2017 Prudential Return (PR). 275 credit unions reported a PR for this period.

Appendix 2 contains a table for both the investment and liquidity framework which illustrates the current framework and the framework which will apply when the amending regulations contained in Appendix 1 are commenced for credit unions.

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[2] Irish and EEA State Securities. The concentration limit for this investment class is currently 70% of total investments.

3. Responses to Questions Posed in CP109

3.1 Potential Additional Investment Classes

Under the existing regulatory framework, credit unions are permitted to invest in a range of specified investment classes which include government bonds, bank deposits, bank bonds and collective investment schemes made up of these instruments. Investments in these classes are subject to specified maturity and concentration limits.

In order to ensure that the investment regulations remain appropriate for the credit union sector, the Central Bank undertook to review the investment regulations in 2017 to consider whether it is appropriate and prudent, at this stage, to facilitate investment by credit unions in other classes of investments.

CP109 highlighted the current level of concentration in credit union investment portfolios with the majority of credit union investments held in accounts in authorised credit institutions (73%) or bank bonds (18%). Additionally, a large proportion of credit union investments are held with a small number of counterparties with nearly 70% of total investments held with only five counterparties. CP109 sought to understand why there is such concentration in investment portfolios and to understand if there are barriers to diversification within the existing investment framework.

CP109 proposed that credit unions be permitted to invest in corporate and supranational bonds and Tier 3 AHBs and set out proposed credit quality, maturity and concentration limits for each of these potential investment classes. This was aimed at helping to ensure that appropriate levels of diversification could be achieved in credit union investment portfolios. CP109 sought views on the appropriateness of the proposed investment classes for credit unions.

Question 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.

Question 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?

Question 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.

Submissions to CP 109

Diversification

A large number of submissions comment on the current level of diversification in credit union investment portfolios and barriers to diversification. A significant number of these submissions note that credit union investment portfolios are concentrated in deposits and under diversified. Some respondents highlight that the range of authorised investments and the resulting diversification options in the 2016 Regulations are very restricted. A small number state that over several years the investment framework has been incrementally reduced so that only "no growth assets" are permitted. A number believe they have little choice other than to consider cash deposits or bank bonds for investments. A small number mention that the low yields available on EU government

bonds means these have not been a worthwhile investment in recent years. A limited number of submissions note that the high percentage of investments in accounts in authorised credit institutions further compounds the impact of negative yields on credit unions.

A significant number of submissions express concerns on changes to the definition of senior Bank Bonds set out in CP109. Further detail on the feedback received in relation to bank bonds is set out in section 4.1.

A limited number of respondents believe that the current liquidity ratio requirements and definitions effectively restrict investment in government and bank bonds and are barriers to the use of existing diversification options within the current investment framework. A small number of respondents suggest expanding the definition of liquid assets, which would assist credit unions in diversifying further and promote investment in bonds.

A limited number of submissions identified lack of investment options as the most significant barrier to diversification in credit union investment portfolios. Another challenge highlighted by limited numbers of respondents is a lack of demand from credit institutions for credit union deposits.

Appropriateness of Proposed Additional Investment Classes

Almost all submissions comment on the appropriateness of the potential additional investment classes. A large number of submissions welcome the introduction of additional investment classes for credit unions, with some submissions highlighting that these proposals provide an opportunity for credit unions to increase the current level of investment diversification and with a limited number stating that they believe that this will help to diversify risk.

A limited number of submissions on this specific question express the view that the proposals are not significant enough to introduce meaningful diversification into credit union investment portfolios and will not have an impact on income. A number of respondents comment that the concentration limits proposed in CP109 limit the potential for credit unions to diversify their investments.

A number of respondents agree with and welcome the specific proposals on supranational and corporate bonds while a small number of submissions express concerns on potential additional risks associated with corporate bonds.

Very few respondents comment on the proposals regarding investment in Approved Housing Bodies in the context of this question but those that did were generally supportive of this as an appropriate investment class for credit unions. The small number of respondents who comment state that the proposals contained in CP109 are broadly in line with their expectations.

Specific feedback provided in submissions on the three potential investment classes is outlined in sections 3.2, 3.3 and 3.4 below.

Other Additional Investment Classes

A large number of respondents comment on the appropriateness of investment in additional investment classes outside of the proposals set out in CP109. A significant number of these respondents request that credit unions be permitted to invest in subordinated debt instruments that are eligible for MREL subject to minimum credit ratings. Section 4.1 sets out an overview of the feedback received in relation to bank bonds and the Central Bank's response to this feedback.

A significant number of respondents suggest that the Central Bank should consider permitting credit unions to invest in semi-state companies and state sponsored projects such as infrastructure projects; including local community, schools or hospitals.

A number of respondents comment that investments in direct equity or equity based products would be appropriate for credit unions, providing diversification benefits.

Respondents suggest that equity exposures could be achieved through collective investments. Examples provided in submissions include UCITS including Exchange traded Funds (ETFs). One submission suggests that credit unions should be permitted to invest in absolute return funds. Submissions from investment advisors also comment that equities could provide diversification opportunities for the credit union sector subject to small concentration limits ranging between 5-10% of total investments.

Self-assessment of investment suitability is suggested by a number of respondents, citing that larger credit unions with sufficient risk, compliance and investment expertise could be permitted to determine their own investment risk appetite and portfolio allocation outside of the parameters set out in the investment framework. Section 4.4 sets out more detail on feedback received in relation to a differentiated or tiered approach to the investment framework.

Some respondents comment that investment in centralised SME or mortgage lending vehicles would benefit the sector. A submission from a representative body suggests that credit unions should be permitted to invest in Credit Union Service Organisations (CUSOs) established for the purpose of the provision of credit union services.

A limited number of respondents also comment on additional investment classes which would facilitate the diversification of credit union investment portfolios such as commodities, Real Estate Investment Trusts (REITs), inflation linked securities and non-EUR denominated investments.

Central Bank Response

Diversification

The amending investment regulations that are set out in Appendix 1, aim to facilitate diversification by providing an enhanced investment framework which is in line with an appropriate level of risk for credit unions and it is viewed will provide appropriate diversification opportunities in terms of investment type and counterparty. Changes to the proposed concentration limits for supranational bonds, corporate bonds and investments in AHBs should increase opportunities for credit unions to diversify their investments. In addition, changes are being made to the liquidity requirements for credit unions, which will see a change to the investments that may be considered as qualifying liquid assets and will facilitate further diversification in investment portfolios. The full details of these liquidity changes are included in section 4.2 with the amending regulations for liquidity included in Appendix 1.

Appropriateness of Additional Investment Classes

The Central Bank welcomes the feedback received on the additional investment classes proposed in CP109 and notes the comments provided. Having considered the feedback received, the Central Bank considers it appropriate to proceed with the introduction of the three additional investment classes proposed in CP109. Further detail on the proposals relating to these investment classes including maturity and concentration limits and credit quality requirements are set out in sections 3.2, 3.3 and 3.4 below.

Other Additional Investment Classes

The primary objects and purpose of a credit union remains the promotion of thrift among its members by the accumulation of their savings and the creation of sources of credit for their mutual benefit at fair and reasonable interest rates. Additionally, under section 43 of the 1997 Act, credit unions are required to ensure investments do not involve undue risk to members' savings. This informs the appropriate level of investment risk that credit unions should be permitted to take and should inform credit unions in setting their own investment risk appetites. As set out in CP109, the Central Bank is of the view that any changes to the investment framework for credit unions should reflect the fact that it is the savings of credit union members (which can be withdrawn on demand) that will be invested by credit unions and that the risk profile of credit union investment portfolios should reflect this. This will necessarily impact on the level of return that appropriate investment portfolios can generate.

This impacts the range of investments that would be considered appropriate for credit unions. In considering potential additional investment classes for credit unions, the Central Bank remains of the view that it is appropriate to focus on the lower end of the risk spectrum concentrating on fixed income investments and investments with particular characteristics that will help to ensure appropriate levels of investment risk for credit unions. The paragraphs below set out the Central Bank's comments on the specific investment classes suggested in submissions to CP109.

State Projects: the amending investment regulations set out in Appendix 1 continue to make reference to the Central Bank's ability to prescribe further classes of investments in which a credit union may invest, which may include investments in projects of a public nature. The Central Bank is open to considering proposals for this type of investment. As was the case with proposals around credit unions investing in social housing, where the Central Bank receives detailed proposals which can demonstrate that an investment could fall within the appropriate risk profile for credit union investments, it will consider further amendments to the investment regulations to facilitate such investments in the future.

Centralised Mortgage Lending/Centralised SME Lending: to date the Central Bank has engaged with sector stakeholders in relation to high level proposals to establish an entity to facilitate centralised mortgage lending by credit unions. The Central Bank will continue to engage with sector stakeholders on these proposals.

Equities: having considered the feedback received, the Central Bank remains of the view that investment in equities falls outside the appropriate risk profile for credit union investments and is of the view that some of the structures proposed for equity investment, could introduce an increased degree of complexity into credit union investment portfolios.

Commodities: the Central Bank is of the view that commodities do not represent an appropriate investment class for credit unions given their risk profile and the level of expertise required to manage such investments.

REITs: the Central Bank is of the view that REITs do not represent an appropriate investment class for credit unions given their risk profile and the level of expertise required to manage such investments.

Inflation-linked securities: credit unions are not currently precluded from investing in inflation-linked securities issued by the Irish and EEA Governments and this will remain the case when the amending investment regulations for credit unions are introduced.

Non-EUR denominated investments: credit unions do not currently have any currency exposures in their balance sheets and the Central Bank does not consider it appropriate for credit unions to introduce currency risk into their investment portfolios. This would introduce additional complexity into credit union portfolios and would require specific competencies to manage associated risks.

CUSOs: the Central Bank is open to giving consideration to how investment in CUSO's providing services to credit unions could be facilitated and will engage with the sector on proposals for the establishment of this type of entity.

The amending regulations set out in Appendix 1 incorporate a number of changes to the proposals outlined in CP109, which are aimed at addressing the feedback received through the consultation process. It is considered that the revised proposals reflected in these regulations will facilitate appropriate levels of diversification across an appropriate range of investment options.

3.2 Bonds issued by Supranational Entities

Proposals set out in CP109

CP109 proposed permitting credit unions to invest in bonds issued by supranational issuers (entities formed by two or more central governments with the purpose of promoting economic development for the member countries). Examples of supranational entities that currently issue euro denominated bonds include the

European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD). CP109 proposed to permit such investments subject to the following limits:

Minimum credit rating: A minimum rating of no less than A or equivalent applied by at least two recognised rating agencies;

Maturity Limit: A maximum maturity limit of 10 years;

Concentration Limit: A maximum investment amount of 50% of the credit union's regulatory reserve, which gives potential for c.€895m investment at a sector level.

Question 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?

Question 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.

Submissions to CP109

Addition of supranational bonds to the list of authorised classes of investments

Almost all respondents to CP109 comment on the proposed introduction of supranational bonds to the credit union investment framework. A large number of respondents welcome this additional asset class, with some noting that permitting investments in supranational bonds would provide diversification benefits for credit unions.

Although a large number of respondents welcome this investment class, a large number also comment on the low yields that are currently available on this type of investment and indicate that investment in this class is likely to have little impact on a credit union's investment portfolio in terms of income generation. A small number of submissions view that supranational bonds are unlikely to form a significant proportion of a credit union's investment portfolio, and a limited number of submissions note that investment in European sovereign bonds is currently possible under the existing framework limiting the impact of adding supranational bonds as a class of investments for credit unions.

Minimum Credit Rating

Some respondents who comment on supranational bonds agree with the proposed credit quality requirement, however a small number disagree with the proposed requirement. A small number of respondents propose that a minimum rating requirement of investment grade may be more appropriate given the risk profile of supranational bonds.

A limited number of respondents comment on the fact that the proposed requirement is inconsistent with the 2016 Regulations, where no credit rating limit has been imposed on existing investment asset classes such as Accounts in Authorised Credit Institutions, Irish and EEA State Securities, and Bank Bonds.

Maturity Limit

A significant number of respondents comment on the proposed maturity limit of 10 years, with almost all of these submissions agreeing with the proposed maturity limit.

Concentration Limit

Almost all respondents who comment on the introduction of supranational bonds as an investment class also comment on the proposed concentration limit for this class. Of these, the majority do not agree with the proposed limit based on the view that the

proposed limit is too low to have a meaningful impact on credit union investment portfolios. A small number of submissions propose that the concentration limit should be calculated as a percentage of total investments, while a further number of respondents propose including supranational bonds specifically in the current limit of 70% of total credit union investments which currently applies to both investments in bank bonds and government bonds.

Some respondents feel that the introduction of concentration limits based on regulatory reserves would add complexity to the management of investment portfolios. A limited number of respondents believe that credit unions should be allowed to choose their own concentration limits.

Central Bank Response

Addition of supranational bonds to the list of authorised classes of investments

Having taken account of the feedback received from respondents, the Central Bank has decided to proceed with the addition of supranational bonds to the list of authorised classes of investments for credit unions. This new investment class will be subject to the following limits:

(i) A minimum credit rating requirement of investment grade (BBB- or equivalent) by at least 2 recognised rating agencies for direct investment or by 1 recognised rating agency for investment through a UCITS;

(ii) A maximum maturity of 10 years;

(iii) A concentration limit whereby exposure to the combination of Supranational Bonds and Irish and EEA State Securities cannot exceed 70% of the total value of a credit union's investments.

Minimum Credit Rating

The new investment class of Supranational Bonds will be subject to a minimum credit rating requirement of investment grade (BBB- or equivalent). This amendment reflects feedback received on the proposed minimum credit rating requirement set out in CP109. This minimum credit rating requirement will also be applied to investments in Irish and EEA State Securities in acknowledgement of the similar risk profile of these two investment classes. In general, credit unions have not invested in lower grade government bonds and this measure will prevent credit unions from investing in such bonds in the future, which could potentially result in undue risk to members' savings. In addition, it is viewed as appropriate that a rating requirement is placed on government bonds taking account of the changes being made to the liquidity framework.

The Central Bank requires that where Irish and EEA State Securities or Supranational bonds are held which no longer meet the minimum rating requirement, the credit union would be required to divest of the bond as soon as possible in order to ensure compliance with the regulations and ultimately to ensure appropriate management of the risks of its investment portfolio.

Maturity Limit

The 10-year maturity limit put forward in CP109 will remain unchanged.

Concentration Limit

In identifying an appropriate revised concentration limit, the Central Bank has assessed the current permissible investment in government bonds under the existing framework and the proposals put forward around the concentration limit for supranational bonds in CP109.

The current framework permits investment in Irish and EEA State securities up to 70% of total investments. Based on current financial data, this would permit an investment in this class of c.€8.2 bn. Total sector holdings in Irish and EEA State securities are currently

c.€0.71 bn., representing c.6% of total sector investments. The concentration limit of 50% of regulatory reserves proposed in CP109 equates to a potential investment of c.€0.9 bn. for supranational bonds.

It is proposed that an overall concentration limit of 70% of total investments is appropriate for a credit union's combined exposure to Irish and EEA state securities and supranational bonds.

Table 1 illustrates the overall potential sector exposure for these investment classes and includes detail on the maximum, minimum and average investment in Irish and EEA state securities and supranational bonds.

Table 1

	Investment €	Investment as a % of Total Assets	Investment as a % of Total Investments
Total exposure to Irish and EEA state securities and supranational bonds[3]	€ 8.2 bn	48.1%	70%
Largest maximum permitted investment[4]	€ 199.2 m	55.2%	70%
Smallest maximum permitted investment[5]	€ 0.11 m	4.9%	70%
Average maximum permitted investment (all credit unions where Total Assets ≥ €100m)	€ 85.9 m	49.9%	70%
Average maximum permitted investment (all credit unions where Total Assets < €100m)	€ 16.8 m	47.7%	70%

The application of an overall concentration limit of 70% of total investments for investments in Supranational Bonds and Irish and EEA State Securities would allow the sector to invest up to €8.2bn across government bonds and supranational bonds. This effectively facilitates the current level of investment in government bonds while providing more scope to invest in supranational bonds than proposed in CP109.

3.3 Corporate bonds

Proposals set out in CP109

Credit unions are currently permitted to invest in bank bonds but not permitted to invest in bonds issued by corporates. CP109 proposed to allow investment in corporate bonds subject to the proposed limits set out below:

[3] Calculated by applying the concentration limit to the total investments of each individual credit union and aggregating for all credit unions.
[4] Calculated by applying the concentration limit to the total investments of each individual credit union and identifying the credit union with the largest maximum permitted investment.
[5] Calculated by applying the concentration limit to the total investments of each individual credit union and identifying the credit union with the smallest maximum permitted investment.

Minimum Credit Rating: A minimum rating of no less than A or equivalent applied by at least two recognised rating agencies;

Maturity Limit: A maximum maturity limit of 10 years;

Concentration Limit: A maximum investment amount of 25% of the credit union's regulatory reserve, which gives potential for c.€448m investment at a sector level.

While the Central Bank acknowledged in CP109 some of the potential diversification benefits of investing in corporate bonds, we are of the view that investing in this investment class represents a significant change for credit unions compared to existing investments and requires a degree of expertise that credit unions will need to develop. CP109 articulated that it is vital that any credit union that undertakes investments in corporate bonds fully understands the specific characteristics of the investment and all associated risks.

CP109 proposed that as with existing classes of investments, under this proposal, credit unions would be permitted to gain exposure to corporate bonds through direct holdings of individual corporate bonds or through collective investment schemes, provided the underlying investments in the collective investment scheme fall within the limits and requirements specified in the regulations.

Question 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?

Question 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.

Submissions to CP109

Addition of corporate bonds to the list of authorised classes of investments

Almost all respondents comment on the introduction of corporate bonds to the credit union investment framework, with a large number welcoming the addition of this investment class. A significant number of submissions note the potential diversification benefits of this asset class, with a number commenting on the opportunity to allocate a portion of the investment portfolio to non-financial counterparties and the potential returns which such an investment may generate. While a limited number of respondents view the lack of regulation in this market as potentially increasing the risk profile of credit union investment portfolios, it is viewed by a number of respondents that the proposed minimum credit rating of no less than A may help to minimise the risks associated with this type of investment.

Minimum Credit Rating

A number of submissions express concerns with the credit rating proposed in CP109, and a significant subset request a minimum credit rating requirement of investment grade. Almost all of these respondents make this request due to a general lower return available on corporate bonds with an A rating, noting that investment grade would help income generation in the current low interest rate environment.

Maturity Limit

The majority of respondents agree with the proposed maturity limit of 10 years.

Concentration Limit

Almost all submissions disagree with the proposed concentration limit, commenting that a higher limit would have a greater impact on diversification. A significant number of

respondents request that the limit be set as a percentage of assets as they feel that the use of regulatory reserves adds an additional degree of complexity. In this respect, a number of responses request that the concentration limit for corporate bonds be included in an overall bond concentration limit of 70% of total investments, which would facilitate credit unions in deciding their fixed income investment strategy relative to their individual risk appetite.

Central Bank Response

Addition of corporate bonds to the list of authorised classes of investments

Having taken account of the feedback received from respondents, the Central Bank has decided to proceed with the addition of corporate bonds as an investment class for credit unions. In recognition of feedback received and following further analysis, the proposed concentration limit set out in CP109 is increased to ensure that this class of investment provides meaningful diversification opportunities for credit unions. In addition, the credit rating requirement proposed in CP109 is being changed where investment in corporate bonds is undertaken via a UCITS. A specific counterparty limit for investments in corporate bonds is being introduced for direct corporate bond investment. This is aimed at seeking to ensure that an inappropriate level of risk is not introduced to credit union investment portfolios and to assist in driving further counterparty diversification. The revised limits for this additional investment class are as follows:

(i) a minimum credit rating requirement of A for direct corporate bond investment by at least 2 recognised rating agencies OR a minimum credit rating requirement of investment grade by at least 1 recognised rating agency for all corporate bond investments through a UCITS;

(ii) a maximum maturity of 10 years;

(iii) a concentration limit of 50% of regulatory reserves, which gives potential for c.€906m investment at a sector level; and

(iv) specific counterparty limit for corporate bond which requires that a credit union shall not make a direct investment in corporate bonds issued by a particular counterparty which would cause the credit union’s direct investments in corporate bonds with that counterparty to exceed 5% of the regulatory reserves of the credit union.

Minimum Credit Rating

Having considered feedback received on the proposed credit rating for corporate bonds set out in CP109 the Central Bank considers it appropriate to change the proposed minimum credit rating to investment grade for investments in corporate bonds through a UCITS. This is in acknowledgement of the diversification benefits which such an investment vehicle provides. A minimum A rating will apply to direct investments in corporate bonds.

For clarity the Central Bank definition of a corporate bond included in the amending regulations as set out in Appendix 1, does not permit investment in bank bonds issued through a holding company.

Maturity Limit

The 10-year maturity limit put forward in CP109 will remain unchanged. This maturity limit will apply to all corporate bond investments invested either directly or through a UCITS.

Concentration Limit

With respect to the concerns raised on the concentration limit, the Central Bank proposes to increase the concentration limit from 25% to 50% of regulatory reserves which gives potential for c.€906m investment in this investment class at a sector level.

Specific Corporate Bond Counterparty Limit

The introduction of a specific counterparty limit for corporate bonds is aimed at ensuring that an inappropriate level of risk is not introduced into credit union investment portfolios. Therefore, it is deemed appropriate that, where a credit union undertakes investment directly in corporate bonds, the credit union does not have a direct exposure to any one corporate bond issuer which is greater than 5% of its regulatory reserves. This specific counterparty limit will also assist in driving counterparty diversification e.g. if a credit union invests to the maximum of 50% of regulatory reserves directly in corporate bonds, this limit will ensure that the overall corporate bond exposure is spread over a minimum of 10 counterparties.

Table 2 illustrates the overall potential sector exposure for this investment class and includes detail on the maximum, minimum and average investment in corporate bonds through UCITS under this concentration limit.

Table 2

	Investment €	Investment as a % of Total Assets	Investment as a % of Total Investments
Total exposure to corporate bonds[6]	€ 906 m	5.4%	8.3%
Largest maximum permitted investment[7]	€ 22.2 m	6.8%	10.2%
Smallest maximum permitted investment[8]	€ 0.06 m	6.3%	10.9%
Average maximum permitted investment (all credit unions where Total Assets ≥ €100m)	€ 9.4 m	5.5%	7.8%
Average maximum permitted investment (all credit unions where Total Assets < €100m)	€ 1.9 m	5.4%	8.5%

We acknowledge the non-financial sector diversification benefits this asset class would bring to credit union investment portfolios and believe this concentration limit would not introduce an inappropriate level of risk into credit union investment portfolios.

3.4 Investments in Approved Housing Bodies

Proposals set out in CP109

Prior to publishing CP109 the credit union sector engaged with the Central Bank in relation to proposals for credit unions to provide funding to AHBs for the provision of social housing. Common bond restrictions limit the potential for credit unions to lend to AHBs, either directly or on a syndicated basis, and as a result proposals have focused on

[6] Calculated by applying the concentration limit to the regulatory reserve of each individual credit union and aggregating for all credit unions.
[7] Calculated by applying the concentration limit to the regulatory reserve of each individual credit union and identifying the credit union with the largest maximum permitted investment.
[8] Calculated by applying the concentration limit to the regulatory reserve of each individual credit union and identifying the credit union with the smallest maximum permitted investment.

investment-based funding. These proposals are based around the establishment of a collective investment vehicle, which would facilitate the provision of credit union funding to AHBs by way of investment.

Having considered proposals brought forward by the sector for investing in AHBs and undertaking research on the AHB sector, including the structure and funding model, the Central Bank outlined proposals in CP109 which would enable credit unions to undertake such investment. CP109 highlighted a number of identified risks and associated risk mitigants for this type of investment and outlined specific limits and requirements, which in the Central Bank's view, would be required in order for credit unions to be permitted to invest in AHBs. These limits are:

***Type of AHB**:* The Central Bank is of the view that it would be appropriate to limit investment to Tier 3 AHBs only, in recognition of the higher level of oversight that these AHBs are subject to from the Housing Agency Regulator.

***Concentration Limit**:* No specific concentration limit was proposed in CP109 but it was acknowledged that any concentration limit would have to be calibrated to take account of the longer term maturity of this investment class, the existing Asset and Liability Management (ALM) framework for credit unions and the maturity mismatch which already exists on credit union balance sheets. The RIA which accompanied CP109 explored some potential concentration limits and it was suggested that the concentration limit could be applied on a tiered basis to reflect the varying degrees of capacity and capability across the sector.

***Maturity Limit**:* Taking account of the nature of social housing projects and the likely duration for such investments, the Central Bank noted that if investments in AHBs were to be permitted that this would require a longer maturity limit for such investments. Therefore, it was suggested in CP109 that a specific maturity limit for investments in AHBs of 25 years would be potentially appropriate.

CP109 sought views from respondents on a number of issues associated with investment in AHBs, including: the appropriateness of investment in AHBs as a new investment class for credit unions, the most appropriate structure for investments in AHBs, key risks and risk mitigants for this type of investment, asset liability management issues, concentration limit and the maturity limit.

Question 8.

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

Question 9

What would the most appropriate structure for investments in AHBs be e.g. investment vehicle?

Question 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?

Question 11.

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

Question 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?

Question 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?

Submissions to CP109

Appropriateness of investments in AHBs

A large number of respondents comment on whether it would be appropriate for credit unions to undertake investments in AHBs with the majority in favour of this additional investment class. A significant number of those in favour cite the alignment of the social goals of both the credit union movement and the AHB sector as the principal rationale for permitting this type of investment. A limited number of respondents also point to investment diversification as a reason why credit unions should be allowed invest in AHBs. Some of those in favour also express a degree of caution with this type of investment, stating that they would like to see further information on the investment structure, risks and potential return. A small number of respondents do not think credit unions should be permitted to invest in AHBs, viewing this type of investment as too risky given the lack of liquidity and long term nature of such investments and noting the associated costs of establishing and managing a centralised investment vehicle as potentially too high to see a meaningful return.

Investment Structure

A large number of respondents comment on what they think would be the most appropriate structure for investments in AHBs. The majority of respondents suggest that a centralised investment scheme or special purpose vehicle would be the most appropriate structure for this type of investment because such collective investments structures would improve the liquidity of the investment and diversify its risk.

Other suggested structures for investment in AHBs by credit unions from a limited number of respondents include an aggregator fund, a unitised investment structure and investment via a government issued housing bond. A limited number of respondents also suggest that credit unions should be permitted to invest directly in AHBs. A small number of respondents suggest that credit unions should have the option to invest in AHBs for the provision of social housing within a credit union's own local area.

Risk and Risk Mitigants

A large number of respondents provide input on what they consider to be the key risks associated with credit unions investing in AHBs and what mitigants they feel are available to manage these risks. Counterparty risk (including regulatory risk) and duration risk (including liquidity risk) were the two main risks identified by respondents. The specific conditions around the funding model for social housing provided by AHBs, including the Capital Advance Lending Facility (CALF), the Payment and Availability (P&A) Agreement and the Continuation Agreement are identified by respondents as being the main risk mitigant for investment in AHBs. Statutory regulation of AHBs and investment in AHBs via a collective investment vehicle are also identified by some respondents as factors that could possibly mitigate the risk of this type of investment.

Asset Liability Management

A large number of respondents comment on how ALM issues associated with such long term investments can be addressed by credit unions. The possible availability of a secondary market for investments by credit unions in AHBs through a centralised investment vehicle is identified by some respondents as a means of increasing the liquidity of such investments. A small number of respondents suggest that a centralised investment vehicle composed of projects of mixed duration would help address ALM issues. A small number of respondents also suggest the introduction of term deposits as a mechanism to extend the duration of credit unions' liabilities with a limited few also

referring to the traditional stickiness of members' savings in credit unions as evidence of an existing tool to address ALM risks associated with investments in AHBs.

A small number of respondents are of the view that the concentration limit for this type of investment should be set at an appropriately conservative level in the initial stages to limit the impact that this type of investment may have on participating credit unions' balance sheets. Finally, a centralised treasury management system for the credit union sector and training on ALM for credit union officers and directors are other ways a limited number of respondents suggest the ALM issues associated with investments in AHBs could be addressed.

Concentration Limit

A significant number of submissions contain views on what an appropriate concentration limit would be for investment in AHBs. A large number of those who expressed views would prefer that the concentration limit be calculated as a percentage of the credit union's total investment portfolio as opposed to a percentage of regulatory reserves as proposed in CP109. Some of those in favour of the concentration limit being calculated as a percentage of the total investment portfolio suggest that a concentration limit of 5% of total investments would be appropriate while a similar number suggest that a higher limit, of between 10-20% of total investments, would be appropriate.

A small number of respondents are in favour of the concentration limit being based on a percentage of a credit union's reserves as was illustrated in the RIA which accompanied CP109. A significant number of these respondents propose a concentration limit of 70-100% of reserves as being an appropriate limit for this type of investment. A limited number of submissions also suggest that the concentration limit could be applied on a tiered basis and that the concentration limit should be reviewed a few years after implementation to ensure it remains appropriate.

A shared treasury management function, a centralised investment vehicle and a demonstrated ability by credit unions of capacity to manage ALM issues are cited by a limited number of submissions as ways to potentially facilitate a larger concentration limit. A similar number of submissions comment that duration matching by credit unions of long term investments in AHBs is not possible and consequently suggest that this type of investment should be subject to a relatively low concentration limit. A further few respondents see existing liquidity requirements as very conservative and sufficient to mitigate liquidity risks associated with this type of long term investment.

Maturity Limit

A large number of submissions comment on the proposed 25-year maturity limit for potential credit union investments in AHBs. Most respondents on this question agree with the proposed 25-year maturity limit with a small number of respondents disagreeing. Of those who disagree, a number propose that a 30-year maturity limit would be more appropriate, citing alignment with the maximum duration of a P&A agreement as a rationale for this longer maturity limit. Another small number of respondents are of the view that the 25 year proposed maturity limit is too long and would introduce too much risk to individual credit union's balance sheets.

Central Bank Response

Appropriateness of Investment in AHBs

Following sector engagement with the Central Bank in relation to proposals for credit unions to provide funding to AHBs for the provision of social housing and having taken account of the feedback from respondents, the Central Bank is of the view that it is appropriate for credit unions to be permitted to provide funding for social housing through investments in AHBs subject to certain requirements and limits. The government support provided to AHBs via P&A agreements and the CALF, the regulatory framework being developed for AHBs and the regulatory limits being put in place by the Central Bank should help to ensure that such investment will not add inappropriate levels of risk to credit unions' investment portfolios. Nonetheless, it is

important that there is realism on the proportion of the sector's surplus funds that could appropriately be allocated to investment in social housing. This must be informed by the specific characteristics of funding for social housing and appropriate levels of risk for members' savings. An important issue highlighted in CP109 is the need for credit unions to take account of maturity considerations and the balance sheet impact of undertaking investments in approved housing bodies which, by their nature, are likely to be illiquid and significantly longer term than existing credit union investments and could result in an increase in the existing maturity mismatch on the credit union's balance sheet. More broadly, consideration will also need to be given to the interplay between any possible move towards more longer-term lending together with longer maturity investments, which could also exacerbate this issue. If credit unions wish to significantly shift the maturity profile of their assets, they will need to consider how they can extend their funding profile, taking account of the demographics of their membership.

The Central Bank will now include investments in Tier 3 AHBs through a regulated investment vehicle as a permitted class of investment for credit unions. This investment class will be subject to the following limits:

(i) Tiered concentration limit as follows:

- 25% of regulatory reserves for those credit unions with total assets less than €100 million; and
- 50% of regulatory reserves for those credit unions with total assets of at least €100 million.

(ii) Maximum maturity of 25 years.

Concentration Limit

Concentration limits have been set at what is viewed by the Central Bank to be an appropriate level to take account of the specific risk profile of this class of investment but also to enable interested credit unions to achieve a scale of collective investment that will allow them to make a meaningful investment in Tier 3 AHBs for the provision of social housing. The concentration limits for this investment class are applied on a tiered basis to take account of the greater degree of sophistication in systems and controls which may be in place in larger credit unions which would increase the capability of these credit unions to manage the particular risks associated with a long term investment of this nature. We are applying the concentration limit for this class of investment based on a percentage of a credit union's reserves as we are of the view that regulatory reserves is the most accurate indicator of a credit unions ability to absorb losses. Table 3 sets out the maximum exposure to tier 3 AHBs that would be permissible under these concentration limits. Table 4 analyses this data for credit unions with total assets greater than or equal to €100m and less than €100m and illustrates the largest and smallest exposures that would be permissible under these concentration limits.

Table 3

Total Sector Exposure to Tier 3 AHB[6]	€ 698 m
Tier 3 AHB Investment represented as a % of Total Assets (average)	3.2 %
Tier 3 AHB Investment represented as a % of Total Investments (average)	4.9 %

Table 4

	Total Assets ≥ €100 million	**Total Assets < €100 million**
Number of Credit Unions	52	223
Total Exposure to Tier 3 AHBs	€ 490 m	€ 208 m
Tier 3 AHB Investment represented as a % of Total Assets (average)	5.5 %	2.7 %
Tier 3 AHB Investment represented as a % of Total Investments (average)	7.7 %	3.9 %
Largest Maximum permitted Tier 3 AHB investment[7]	€ 22.2 m	€ 2.7 m
- As a % Total Assets	6.8 %	2.9 %
- As a % Total Investments	10.2 %	4.3 %
Smallest Maximum permitted Tier 3 AHB investment[8]	€ 5.22 m	€ 0.03 m
- As a % Total Assets	5 %	3.2 %
- As a % Total Investments	7.9 %	5.5 %

Maturity Limit

The 25-year maturity limit put forward in CP109 will remain unchanged.

3.5 Other considerations

3.5.1 Counterparty Limit

Proposals set out in CP109

Regulation 26 of the 2016 Regulations requires that a credit union shall not make an investment with a counterparty, which would cause the investments with that counterparty to exceed 25% of the credit union's total investments. CP109 noted the high level of concentration to individual counterparties which currently exists in credit union investment portfolios, with close to 70% of overall sector investments held with just five counterparties.

In light of the potential new investment classes being introduced, CP109 proposed a reduction in the counterparty limit from 25% to 20% of total investments, with the objective of encouraging diversification and reducing counterparty risk. It was proposed that a 12-month transitional period would be provided in order to facilitate credit unions in achieving compliance with the reduced counterparty limit.

Question 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.

Question 15

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

Submissions to CP109

Almost all submissions comment on the proposal to reduce the counterparty limit to 20% of total investments. Almost all of these submissions disagree with the proposed reduction in the limit. Concerns raised mainly relate to the difficulty which is being experienced by credit unions in finding suitable counterparties due to the current interest rate environment and the departure of certain counterparties from the Irish market. In addition, it is viewed by a small number of submissions that the proposals put forward in CP109 are insufficient to warrant a reduction in the counterparty limit at this time. Of the submissions which disagree with a reduction in the counterparty limit, some suggest that the counterparty limit should remain at 25%, while others do not put forward suggestions on an alternative counterparty limit. A small number of submissions agree with the proposal to reduce the counterparty limit with one submission citing that this would help to reduce investment risk especially in light of a bail-in scenario if one individual financial institution failed.

A large number of submissions comment on the proposed transitional arrangement for a reduction in the counterparty limit. Almost all of these submissions disagree with the 12-month transitional arrangement on the basis that the issue of a transitional arrangement should not arise given the general disagreement with the reduction in the counterparty limit. Of those that disagree with the proposed transitional arrangement some suggest that, notwithstanding any transitional arrangement, credit unions should be permitted to hold to maturity all fixed term investments. An alternate transitional arrangement of 24 months was put forward by some submissions.

Central Bank response

The Central Bank notes the feedback received on the proposal for a reduction in the counterparty limit and the associated transitional arrangement but having considered the feedback remains of the view that a reduction to 20% of total investments for the

overall counterparty limit is appropriate. However, in order to take account of the feedback on proposed transitional arrangements this will be amended to allow a 24-month period, post commencement of the amending regulations, for credit unions to become compliant with this reduced limit. In addition, it will be permitted that a credit union may hold to maturity any fixed term investment which they hold at commencement of the amending regulations which would result in the credit union being non-compliant with the reduced counterparty limit. The Central Bank's decision to proceed with the reduction in the counterparty limit has taken account of changes to the proposals on concentration limits set out in CP109 and the decision to amend existing liquidity requirements and additional analysis undertaken on counterparty exposures in the sector.

As noted in section 3.3, the Central Bank also considers it appropriate to introduce an additional counterparty limit of 5% of regulatory reserves where direct investment in corporate bonds is undertaken to help to ensure that corporate bonds do not introduce an inappropriate level of risk to credit union investment portfolios. The counterparty limit for corporate bonds will ensure that, if direct investment is undertaken up to the maximum permitted concentration limit of 50% of regulatory reserves, the exposure is spread over a minimum of 10 counterparties.

Analysis which supports final decision

In arriving at the decision to reduce the counterparty exposure limit and in light of the feedback received, the Central Bank undertook further analysis to assess the potential impact which a reduction in the counterparty exposure limit will have for individual credit unions. This analysis is based on updated June 2017 Prudential Return data.

Table 5 illustrates the number of counterparties with which credit unions currently hold investments. As illustrated, over 98% of credit unions hold investments with at least 5 different counterparties with the majority having investments with between 9 and 12 counterparties. This suggests that there are a broad range of counterparties available to credit unions.

Table 5

Number of Counterparties	Number of Credit Unions
4 or less	3
5 to 8	107
9 to 12	138
13 to 16	27
Total:	**275**

Table 6 illustrates that over 80% of credit unions hold an investment with a counterparty which exceeds 20% of total investments[9]. This table also illustrates the total amount of investments which would require to be re-allocated to an alternate counterparty in order to ensure compliance with the reduced counterparty exposure limit of 20% of total investments[10].

Table 6

No of Counterparties >20%	Number of Credit Unions	% of Credit Unions	Total Value of Investments to be reallocated
0	52	18.9%	€0
1	96	34.9%	€103.8m
2	79	28.7%	€145.2m
3	42	15.3%	€63.9m
4	6	2.2%	€4.1m
Total	**275**		**€317m**

Analysis suggests that of the credit unions who would be required to re-allocate an element of their investments to alternate counterparties the majority of these would require a re-allocation of less than 10% of their total investments. See Table 7 for further details.

Table 7

% of Total Investments requiring reallocation	Number of Credit Unions	Total Value of Investments to be reallocated
< 10%	196	€268.1m
≥ 10% and < 20%	20	€33.5m
≥ 20%	7	€15.4m
Total	**223**	**€317m**

[9] While credit unions may hold investments across multiple counterparties these are not evenly split across these counterparties.

[10] This is on the assumption that such investments which are in excess of the 20% counterparty limit are not fixed term investments. The Central Bank acknowledges that, in line with the transitional arrangements, where such investments are fixed term they may be held to maturity and no re-allocation will be necessary.

Conclusion

The Central Bank is of the view that the amended investment framework, as detailed in the amending regulations in Appendix 1, provides credit unions with sufficient opportunity to re-allocate the necessary proportion of their investment portfolio in order to achieve compliance with a reduced counterparty exposure limit. Corporate bond and supranational bond investments will introduce additional counterparty opportunities and diversification potential for credit unions which previously did not exist. The Central Bank acknowledges that not all credit unions will choose to invest in the additional investment classes being added to the investment framework but we are of the view that there are sufficient opportunities for credit unions to achieve diversification to alternate investments including bank deposits and government bonds, both domestically and within Europe. In addition, the changes outlined in this feedback statement around liquidity may assist credit unions in diversifying their investments into products which have been previously under-utilised in the sector.

3.5.2 Collective Investment Schemes

Proposals set out in CP109

The 2016 Regulations provide that credit unions may invest in collective investment schemes comprised of permitted investment classes which include bank deposits, bank bonds and government bonds. Analysis undertaken prior to publication of CP109 indicated that there is limited use by credit unions of collective investment schemes. Based on December 2016 prudential return data, only c.3% of total investments are held in collective investment schemes. CP109 sought views from respondents on the use of collective investment schemes and aimed to establish whether there are any barriers to credit unions using collective investment schemes in the existing investment regulatory framework.

Question 16

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

Question 17

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

Submissions to CP109

A large number of submissions comment on the use of collective investment schemes by credit unions with a significant number of these respondents supporting or advocating their use as an appropriate investment for credit unions. Some of these respondents cite the diversification benefits across multiple counterparties as a reason why such investment is appropriate for credit unions. A small number mention that the benefits of investing via a collective investment scheme include the active management of investments by experienced fund managers and the separate and additional regulatory framework that underpins such schemes. A limited number only advocate investing in those collective investment schemes that are listed with a daily price and have no lock-in periods.

When focusing on possible barriers, a significant number of submissions state that investments in collective investment schemes are effectively restricted by the 2016 Regulations to low yield investments in Irish and EEA state securities, bank bonds and accounts in authorised credit institutions and that the list of permitted investments for collective investment schemes should be widened. A small number of respondents express concerns around supply in the market, as the cost of running such schemes is prohibitive against the current backdrop of low interest rates. There are recommendations by a small number that the definition of collective investment schemes should be expanded to incorporate investments in supranational bonds, corporate bonds, social housing/AHBs, state sponsored projects and equities.

Some respondents suggest that low credit union take-up of collective investment schemes may be due to the required accounting treatment under FRS 102 where a fair value valuation is required as opposed to a valuation based on amortised cost, which is more preferable for credit unions. A small number also suggest that the setup costs associated with such investments may be too high if the Central Bank does not authorise the vehicle and that this level of uncertainty needs to be assessed appropriately. A small number simply state that it is difficult for advisers to build a critical mass of credit unions to cover and sufficiently dilute the costs involved in setting up a collective investment scheme. Finally, a small number of respondents suggest that lack of knowledge of collective investment schemes is a barrier to investment.

Central Bank Response

The Central Bank is supportive of the use of collective investment schemes within appropriate limits and in particular acknowledges the diversification benefits that can be achieved through the use of such structures. The risk mitigation provided by the use of well diversified funds has facilitated the amendment to the minimum credit rating for corporate bond investments through a UCITS to investment grade from the single A minimum proposed in CP109. The amending regulations will expand the permitted classes of investments of which a collective investment scheme can be composed to also include corporate bonds and supranational bonds. This should provide further opportunities for investment in collective investment schemes by credit unions and help to drive further diversification in credit union investment portfolios. Based on analysis undertaken by the Central Bank it is considered that UCITS are the most appropriate structure for credit union investments in collective investment schemes.

When investing in UCITS credit unions should 'look-through' to the underlying holdings and counterparties held in the UCITS in order to ensure that the total investment portfolio of the credit union is in compliance with all regulatory requirements for investments. For example, where a credit union has a direct exposure to a counterparty and holds an investment in a UCITS with exposure to that same counterparty, the credit union should aggregate both exposures to determine their total exposure to that counterparty and to ensure compliance with the counterparty limit.

Where a credit union is investing via a UCITS, the Central Bank considers it appropriate that the UCITS has a minimum total assets size of €150 million and this has been reflected in the amending Regulations which are contained in Appendix 1. This is aimed at ensuring that credit unions invest in well-established diversified funds.

3.6 Proposed Timelines and Transition Period

Proposals set out in CP109

CP109 set out proposed next steps and timelines for the introduction of potential changes to the investment framework for credit unions out in the consultation paper.

	Step
11 May 2017	Consultation Paper on Potential Changes to the Investment Framework for Credit Unions published
28 June 2017	Consultation period closes
Q4 2017	Publish feedback statement and final regulations
Q4 2017	Commencement of final regulations

Question 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.

Submissions to CP109

A large number of submissions comment on the proposed timelines set out in CP109. Over half of these agree with the proposals set out in CP109 particularly in relation to the proposed additional classes of investments. As set out in section 3.5, a large number of submissions raise concerns on the proposed transitional period for the reduction in the counterparty limit from 25% to 20% of total investments.

Central Bank Response

Having considered the submissions received, the Central Bank considers a commencement date of 1 March 2018 appropriate. However, we have increased the counterparty limit transitional arrangement, following commencement of the amended regulations, from 12 months to 24 months.

Transitional Arrangements

When the 2016 investment regulations were commenced on 1 January 2016, transitional arrangements were put in place for investments made prior to the commencement of the 2016 regulations that were in compliance with the legal and regulatory framework that was in place before the commencement of the 2016 regulations. On commencement of these regulations, credit unions were permitted to hold any investments that were not in compliance with the 2016 regulations for a period of two years from 1 January 2016. Where such investments had a fixed maturity date, credit unions were permitted to hold these investments until maturity, on the basis that they were in compliance with all requirements applying at the time the investment was undertaken. The two-year transitional period provided for under the 2016 Regulations expired at the beginning of 2018.

The amending regulations also contain transitional arrangements in relation to investments made prior to the amending regulations coming into force. As with the transitional arrangements applied in 2016, credit unions will be permitted to hold any investment that is not in compliance with the amending regulations for a period of two years where this investment was made in compliance with the applicable investment requirements which applied at the time the investment was undertaken. Additionally, where such investments have a fixed maturity date, credit unions will be permitted to hold them until maturity.

Communications and Guidance for Credit Unions

In order to assist credit unions in implementing the amending regulations, before the regulations commence on 1 March 2018, the Central Bank will develop a FAQ document for credit unions to address questions on the implementation of the changes to the investment framework regulations. This will be published in February 2018 and will be updated as appropriate based on questions raised by credit unions.

The Central Bank will also update the Investment and Liquidity Chapters of the Credit Union Handbook to reflect the changes being made to the investment framework. The updated Credit Union Handbook will be published in February 2018.

Timelines and Transition Period	
Date	**Step**
February 2018	Transition period before the amending regulations commence
February 2018	Publication of updated Credit Union Handbook and FAQ
1 March 2018	Commencement of amending investment and liquidity regulations
Q1 2020	Central Bank will perform and publish analysis of the impact which changes to the investment framework have had over the preceding two year period

4. Other Feedback

4.1 Bank bonds

Proposals set out in CP109

CP109 set out information on changes arising from the introduction of the BRRD. CP109 noted that it is important that credit unions understand the risk implications arising from the BRRD for their investment portfolios and ensure that the instruments they invest in continue to be within their risk appetite. CP109 further noted that the Central Bank is of the view that it is appropriate that credit unions would not be permitted to invest in subordinated debt instruments that are eligible for MREL given their risk profile and the potential implications for credit unions should the institution that issued the instrument enter into resolution. Arising from this, CP109 indicated that the Central Bank was proposing to amend the definition of bank bonds in the 2016 Regulations to clarify that bonds that are subordinated to any senior bonds issued by a credit institution do not fall within the definition of "bank bonds" set out in the regulations.

Submissions to CP109

A large number of submissions comment on the proposal to amend the definition of bank bonds in the 2016 Regulations. These submissions raise concerns on the potential impact of the proposed change noting that bank bonds are a significant class of investment for credit unions. Concerns were expressed that future bond issuance is likely to be made up of MREL eligible bonds and that as a result bank bonds available for credit unions to invest in will be severely curtailed which could impact on the ability of credit unions to generate income from investment portfolios. A number of submissions question whether it is appropriate to focus on the ranking of bonds and not the credit quality of the issuer and suggest permitting investment in subordinated debt instruments that are eligible for MREL subject to a minimum credit rating. A small number of submissions suggest that while such bonds are not appropriate for all credit unions that a tiered approach should be taken whereby credit unions that could demonstrate that they had appropriate expertise could be permitted to invest in subordinated debt instruments that are eligible for MREL.

A number of submissions note the higher level of investment risk involved in these bonds.

Central Bank Response

The Central Bank recognises the impact that the amendment to the definition of bank bonds in the 2016 Regulations to clarify that bonds that are subordinated to any other liability of a credit institution do not fall within the definition of "bank bonds", may have on the available investment options for credit unions. It is noted that some issuance of bonds by credit institutions may not fall within the proposed amended definition of bank bonds it is further recognised that this may impact on the ability of credit unions to achieve appropriate levels of diversification in investment portfolios and this has been considered as part of the overall review of investment regulations.

The Central Bank remains of the view that it is appropriate that credit unions would **not** be permitted to invest in debt instruments that are subordinated to senior liabilities issued by the same credit institution given their complexity and risk profile and the potential implications for credit unions should the instruments be written down or converted into equity.

We are of the view that a number of the proposed changes set out in this feedback statement will address some of the concerns raised in submissions in relation to the proposed amendment to the definition of bank bonds in terms of availability of investments. These include the changes in the concentration limit for supranational and corporate bonds and the changes being made to liquidity requirements which will provide other diversification options for credit unions.

4.2 Liquidity

Submissions to CP109

The liquidity requirements for credit unions are contained in the 2016 Regulations[11] and the section 35 Regulatory Requirements for Credit Unions[12] (Section 35 requirements). Credit unions are currently required to hold liquid assets up to a specific % of unattached savings. The short term liquidity ratio requires that credit unions hold at least 5% of unattached savings in short term liquid assets, those assets which can be accessed within 8 days. The minimum liquidity ratio requires that credit unions hold at least 20% of unattached savings in liquid assets which can be accessed within 3 months. In addition, credit unions who have more than 20% of their total loans maturing after 5 years are subject to increased liquidity requirements under the Section 35 requirements.

Although not specifically consulted upon in CP109, a large number of submissions comment on liquidity highlighting pressures which credit unions are currently facing in relation to liquidity requirements. A number of submissions raise concern or express disappointment that liquidity was not addressed in CP109. A small number of submissions comment that short term/overnight deposits are heavily relied upon to meet liquidity requirements, particularly the short term liquidity requirement. A significant number of submissions highlight the challenges being encountered from an investment perspective with the negative rates being offered on short term investments and the decreasing appetite of domestic financial institutions for such investments.

A large number of submissions that comment on liquidity suggest that certain bonds should be permitted to qualify as liquid assets for the purposes of meeting liquidity requirements and it is noted that such an approach to liquidity is taken under European Banking Regulation and UK Credit Union Regulation. A number of these submissions suggest that government bonds, corporate bonds and supranational bonds should be counted as liquid assets. A smaller number of these submissions suggest that a discount should be applied to such bonds.

Central Bank Response

Analysis Undertaken

In light of the submissions received on liquidity, the Central Bank undertook analysis on the liquidity position of credit unions with a view to better understanding how the liquidity requirements are impacting on individual credit unions and the sector more broadly. Based on data submitted on the June 2017 Prudential Returns by individual credit unions, it appears that the majority of credit unions are operating with liquidity requirements significantly in excess of what is required. The average short term liquidity ratio for the sector is c.22% and the average minimum liquidity ratio is c.36%. Table 8 illustrates the number of credit unions within each liquidity bucket for each of the required liquidity ratios.

[11] 2016 Regulations available here.
[12] Section 35 Requirements available here.

Table 8

Liquidity Ratio		Short Term Liquidity Ratio	
Ratio %	**No of Credit Unions**	**Ratio %**	**No of Credit Unions**
Less than 20%	0	Less than 5%	1
≥20% and <30%	111	≥5% and <10%	29
≥30% and <40%	96	≥10% and <15%	61
> 40%	68	> 15%	184
Total	**275**		**275**

Further analysis was undertaken to quantify the level of additional liquidity, for both the short term liquidity and minimum liquidity requirements, which is currently being held across the sector. Where a credit union holds additional liquidity this may further exacerbate the challenges which are currently being experienced in generating a sufficient return on investment portfolios in the current interest rate environment.

Short Term Liquidity Requirement

All credit unions are required to hold short term liquid assets which are at least equal to 5% of unattached savings. As indicated, a number of the submissions to CP109 outline that credit unions are currently being charged by credit institutions for placing deposits with them overnight/on a short term basis. Based on the current short term liquidity ratio requirement, analysis was undertaken to establish what level of liquid assets are currently being held short term (with a maturity of less than 8 days) in excess of what is required under the 2016 Regulations.

The analysis has been undertaken on the basis that credit unions may wish to operate with an element of excess short term liquid assets. This would allow for fluctuations in the level of unattached savings and would help to ensure that the credit union would be likely to remain in compliance with the short term liquidity requirement on an ongoing basis. The buffer assumed for this scenario is 5%[13] which results in a 10% short term liquidity requirement being used to assess whether a credit union holds additional short term liquidity. The results of the analysis are displayed in Table 9.

[13] The Central Bank is not advocating that credit unions hold liquid assets in excess of the liquidity requirements equal to 5% of unattached savings. It remains a matter for an individual credit union to determine what level of liquidity is appropriate to be held in excess of the minimum requirement relative to the nature, scale, complexity and risk profile of the credit union.

Table 9

Assuming credit union has a short term liquidity ratio of 10%:	
Number of Credit Unions with Additional Short Term Liquidity vs level required in regulations plus 5% buffer	245
Total Value of Additional Short Term Liquid Assets held across the sector	c.€946 million

Minimum Liquidity Ratio Requirement

Similar analysis to the above was undertaken for the minimum liquidity ratio. Once again, it was assumed that credit unions may wish to operate with an element of excess liquid assets, which would allow for fluctuations in the level of unattached savings and which would help to ensure that the credit union would likely remain in compliance with the minimum liquidity requirement on an ongoing basis. An arbitrary buffer of 5%[13] was selected and was applied to the minimum liquidity requirement of each individual credit union, taking account of where credit unions have a liquidity requirement in excess of 20% due to their level of overall lending which is greater than 5 years. The results of this analysis are displayed in Table 10.

Table 10

Assuming credit union has a minimum liquidity ratio of the required % plus a 5% buffer:	
Number of Credit Unions with Additional Liquidity vs level required plus 5% buffer	233
Total Value of Additional Liquid Assets held across the sector	c.€705 million

The evidence based on analysis undertaken does not fully support the concerns expressed by a number of the submissions to CP109 regarding the availability of investment options which meet existing liquidity definitions and related challenges in meeting existing liquidity requirements. While the analysis which is presented above is based on the entire sector and the profile of individual credit unions may not reflect the overall sector profile, the Central Bank would expect credit unions generally to take a more proactive approach to managing liquidity to strike a balance between meeting liquidity requirements and ensuring that investments do not involve undue risk to members' savings.

The 2016 Regulations introduced a change to the definition of liquid assets which was aimed at allowing a credit union to count as liquid those assets which have a maturity of greater than 8 days or 3 months. They must also have a written guarantee to the effect that the funds are available to the credit union in less than 8 days or 3 months, for the purposes of meeting the short term liquidity ratio and liquidity ratio respectively. Analysis appears to support feedback that has been provided to the Central Bank (outside of this consultation) that in practice credit unions cannot obtain such written

guarantees on their investments and therefore this provision cannot be used for the intended purpose by credit unions.

Central Bank Response

Having considered the feedback received on liquidity through the consultation process and in the interest of promoting asset class and counterparty diversification, the Central Bank is now making a number of changes to the liquidity framework for credit unions. Appendix 1 contains amending liquidity regulations for credit unions. These changes are aimed at streamlining the liquidity framework, addressing some of the concerns expressed by submissions to CP109 in relation to the costs associated with meeting existing liquidity requirements and driving further diversification in investment portfolios where the credit unions risk appetite provides for investment in these investment classes. The changes which will be made to the liquidity framework are summarised as follows with further explanation on each of the changes outlined below:

(i) Change to the definition of liquid assets;

(ii) Requirements relating to the make-up of the minimum liquidity ratio in terms of cash and investment composition; and

(iii) Incorporation of the short term liquidity requirement within the minimum liquidity requirement.

The minimum liquidity ratio of 20% of unattached savings will remain in place. The additional liquidity requirements contained in the Section 35 Requirements, which apply where a credit union has more than 20% of its loans outstanding for more than 5 years, also remain in place.

(i) Definition of Liquid Assets

Taking account of the feedback received and having explored the approach adopted in other jurisdictions, the Central Bank will permit certain bonds as qualifying liquid assets. Irish and EEA state securities, supranational bonds and bank bonds subject to an appropriate discount applied to market value will be permitted to count towards meeting the minimum liquidity requirement. There will be a maximum amount of these bonds which will be permitted to count towards liquidity; this is further outlined in (iii) below.

Discounts will be applied to the market value of these bonds at the following rates, depending on the remaining maturity of the investment product.

Remaining Maturity of Investment Product	Discount to Market Value of Product
> 3 months and < 1 Year	10%
1-5 Years	30%
> 5 Years	50%

The definition of liquid assets will remove the provision which was included and which was aimed at allowing a credit union to count as liquid those assets which have a maturity of greater than 8 days or 3 months, but have a written guarantee to the effect that the funds are available to the credit union in less than 8 days or 3 months, for the purposes of meeting the short term liquidity ratio and liquidity ratio respectively. This is in acknowledgement of the feedback received that this is not something which is available to credit unions in practice.

There will be one definition of liquid assets included within the liquidity regulations, as follows:

(a) cash;

(b) investments with a maturity of less than 3 months, excluding the minimum reserves;

(c) Irish and EEA state securities, supranational bonds and bank bonds which have a maturity of greater than 3 months (with the required discounts applied to market value dependent on remaining time to maturity of the investment).

(ii) Composition of Liquidity

The following will apply to the composition of the minimum liquidity ratio of 20% of unattached savings:

(a) at least 2.5% of unattached savings must be available in cash and investments with a maturity of less than 8 days.;

(b) no more than 10% of unattached savings is permitted to come from (c) within the definition of liquid assets as specified above.

Provision (a) has been incorporated to ensure that a minimum element of cash is always available for the credit union to meet any on demand repayment requirements which arise.

Placing a maximum cap on the amount of bonds which may qualify as liquid is aimed at ensuring that there is sufficient diversification, in terms of investment product and maturity duration, within the make-up of liquid assets and that there is not an over-reliance on one source of investment to meet the liquidity needs of a credit union.

The remaining components of the liquidity ratio may be allocated from cash or those investments which have a maturity of less than 3 months. Subject to the requirements outlined above, it is a matter for the credit union to decide how to allocate their investments for the purposes of meeting the liquidity requirement.

(iii) Short Term Liquidity Requirement

Taking account of the requirement that a specific proportion of the minimum liquidity requirement is required to come directly from cash, it is no longer deemed necessary that there is a separate short term liquidity requirement. In effect, the short term liquidity requirement of 5% of unattached savings has been reduced to 2.5% and incorporated within the existing 20% liquidity requirement.

The FAQ document which the Central Bank will publish in advance of the commencement of the amending regulations will provide illustrative examples of how liquidity requirements may be assessed and calculated under the new liquidity framework.

The Central Bank has undertaken analysis to assess the likely impact which these changes to the liquidity framework will have for credit unions. This analysis is by reference to the liquidity requirement for each individual credit union (either 20% or a higher amount as required by the Section 35 Requirements).

Cash and Investments with Less than 8 days to Maturity

Based on data submitted on the June 17 Prudential Returns by credit unions and as outlined previously, all credit unions with the exception of one currently meet the short term liquidity requirement of 5% of unattached savings and as a result should not have difficulty in meeting component (a) of the revised liquidity requirement which requires 2.5% of unattached savings is held in cash and investments with a maturity of less than 8 days.

Allowable Government, Supranational and Bank Bonds

Credit unions currently hold c.€2.2bn and c.€0.7bn in bank bonds and government bonds respectively. Based on the current level of unattached savings a maximum of c.€1.3bn of the overall liquidity requirement for credit unions may come from holdings of bank, government and supranational bonds (after application of the relevant discounts). Based on the current bond holdings of credit unions and after application of the relevant discounts, there is c.€1.9bn of bonds which could potentially qualify as liquid assets across the sector. 118 credit unions currently hold bonds up to and in excess of the maximum amount allowable in meeting the liquidity requirement (i.e. 10% of unattached savings). The remaining 157 credit unions may benefit from undertaking additional investment in bond holdings which may qualify as liquid assets as their current bond holdings are not up to the maximum allowable amount. The Central Bank views that this may be an incentive for credit unions to further diversify their investment portfolios both in terms of gaining exposure up to the maximum allowable amount for liquidity and maintaining that exposure as existing bond holdings mature and reinvestment is required.

4.3 Additional Investment Analysis Provided

Submissions to CP109

A significant number of respondents provide financial impact analysis on a number of the proposals set out in CP109. This analysis focuses on the potential impact on income arising from the proposals set out in CP109 and was prepared by an investment advisor for the majority of respondents. At a sectoral level, the analysis provided indicates that if no changes were made to the investment framework that the average income for the sector would be 0.31%. This analysis sets out 5 additional scenarios and associated weighted average income levels for the sector as follows:

- MREL eligible subordinated bank bonds not permitted, credit unions do not allocate to supranational or corporate bonds - weighted average income for the sector 0.24%.
- MREL eligible subordinated bank bonds not permitted, credit unions do allocate to supranational and corporate bonds - weighted average income for the sector 0.25%.
- MREL eligible subordinated bank bonds are permitted, credit unions do not allocate to supranational or corporate bonds – weighted average income for the sector 0.34%.
- MREL eligible subordinated bank bonds are permitted, credit unions do allocate to supranational or corporate bonds – weighted average income for the sector 0.31%.
- MREL eligible subordinated bank bonds are permitted, credit unions do allocate to supranational or corporate bonds and certain bonds may be interpreted as liquid for calculation of liquidity ratios – weighted average income for the sector 0.35%

None of the scenarios above assume any allocation to investments in AHBs.

Analysis from another investment advisor focuses on the impact of the change to definition of senior bank bonds indicating that the "cost to the sector given the current mix at long term returns, would be c.€50m out of c.€230m of total sector income as measured like for like". This was based on average returns for the sector between 2003 and 2017.

A significant number of respondents also provide analysis on the impact of the proposed reduction in the counterparty limit from 25% to 20% of total investments. This indicates that c.11% of portfolios would need to be reallocated between counterparties to ensure compliance with the revised counterparty limit.

Central Bank Response

As previously stated, credit union investment portfolios should reflect the objects of credit unions and the fact that it is members' savings that are being invested by credit unions. The primary objects and purpose of a credit union remains the promotion of thrift among its members by the accumulation of their savings and the creation of sources of credit for their mutual benefit at fair and reasonable interest rates. Additionally, under section 43 of the 1997 Act, credit unions are required to ensure investments do not involve undue risk to members' savings.

This informs the appropriate level of investment risk that credit unions should be permitted to take and should inform credit unions in setting their own investment risk appetites. As set out in CP109, the Central Bank is of the view that any changes to the investment framework for credit unions should reflect the fact that it is the savings of credit union members (which can be withdrawn on demand) that will be invested by credit unions and that the risk profile of credit union investment portfolios should reflect this. This will necessarily impact on the level of return that appropriate investment portfolios can generate.

While the Central Bank's focus is appropriate levels of risk rather than return, we note the potential for the proposed changes outlined in this feedback statement, including the changes to concentration limits and liquidity requirements, to have some positive impact on income generation.

4.4 Tiered Approach to Investment Regulation

Submissions to CP109

A limited number of submissions suggest that the investment framework should be tiered to allow flexibility for those credit unions that possess the skills and systems necessary to manage a more complex investment portfolio. It is also suggested in a limited number of submissions that credit unions should be able to apply for an exemption from investment regulations which would facilitate certain credit unions to operate outside the regulations where they can demonstrate they possess the necessary skills, knowledge and experience.

Central Bank Response

The revision to the concentration limits for investments in AHBs set out in this feedback statement will introduce an element of tiering into the investment framework. The Central Bank is of the view that the revised investment framework provides sufficient flexibility for individual credit unions to manage their individual investment portfolios within appropriate risk parameters and relative to their own investment risk appetite.

5. Consultation under section 84A of the Credit Union Act, 1997

Following consideration of the submissions received on CP109 the Central Bank provided draft amending regulations, along with an overview of the feedback received on CP109, to the Minister for Finance and the Credit Union Advisory Committee (CUAC) in line with the statutory consultation required under section 84A of the 1997 Act. While a number of the credit union bodies made detailed submissions on CP109, these bodies were also provided with the draft regulations and related documentation and invited to provide any additional comments ahead of finalisation of the amending regulations.

Feedback Received

The Minister for Finance commented on a number of positive changes being introduced through the regulations including the additional asset classes and the changes to the liquidity requirements. Concerns were expressed that certain aspects of the regulations may serve to negatively impact on the profitability of the sector without a corresponding positive impact in terms of reducing the risk to members' funds. The importance of bank bonds as a class of investment for credit unions was highlighted and the likely implication for credit union investments as a result of the change to the definition of bank bonds was articulated. With regards to the revised liquidity requirements and reduced counterparty limit, questions were raised as to whether the discounts required for certain qualifying liquid assets are in line with those applied to credit institutions in Ireland and the EU and whether there are sufficient counterparties accepting cash and investments with short maturities which would allow credit unions to actively manage their cash and investment amongst counterparties. A question was posed on whether there are enough compliant funds which would allow credit unions to diversify investment income through investments in funds. Further information was requested on the impact the changes in the regulations are expected to have on credit unions, particularly their profitability. The Minister for Finance welcomed the review which the Central Bank has committed to undertake two years post commencement of the regulations to assess the impact which the regulations have had.

CUAC also expressed concerns in relation to the change to the definition of bank bonds which will see credit unions excluded from investing in bonds which are subordinated to any other liability of a credit institution and the implication that this may have on investment returns. CUAC also questioned whether, given the concentration limits, investment in corporate bonds was a realistic investment class for credit unions. Concerns were expressed on the minimum fund size for UCITS investments as this could potentially exclude a large number of regulated funds from consideration and in effect could allow for diversification in theory but not in practice. The importance of a RIA was highlighted in order for interested stakeholders to properly assess the likely impact of new regulations on the sector.

Both the Minister for Finance and CUAC requested with regards to investment in Tier 3 AHBs that the regulations be amended quickly if required so as not to inhibit appropriate funding structures which may be established or proposed over time.

The Irish League of Credit Unions, the Credit Union Development Association and the Credit Union Managers' Association collectively responded to the statutory consultation. The response received requested clarifications on a number of aspects of the draft regulations and reiterated concerns which had been expressed in their individual submissions to CP109, mainly in relation to changes to the definition of bank bonds/likely impact on investment returns and the reduction in the counterparty limit from 25% to 20% of total investments. Concerns were expressed in relation to the minimum funds size for UCITS contained in the draft regulations. The Central Bank met with these credit union bodies to discuss their submission to the statutory consultation in advance of issuing a formal response. At this stage useful feedback was received in relation to the technical wording of the regulation permitting Tier 3 AHB investments.

Central Bank Response

Having considered the feedback received through the statutory consultation process the Central Bank made a number of amendments to the draft regulations. These changes primarily related to the minimum fund size for UCITS investments and the wording of the regulations relating to investment in Tier 3 AHBs and shares of a society registered under the Industrial and Provident Societies Acts. These changes are reflected in the regulations which are included at Appendix 1.

As outlined in section 4.1 the Central Bank recognises the impact which the change to the definition of bank bonds, to preclude investment in bank bonds which are subordinated to any other liabilities of a credit institution, may have. It is noted that issuance of bonds, in the near term, by domestic credit institutions may not fall within the proposed amended definition of permitted bank bonds. However, credit unions will continue to be permitted to invest in senior bank bonds and we understand that European credit institutions will continue to issue senior bank bonds. Additionally, as MREL 'buffers' are established, it is expected that domestic credit institutions will resume issuance of senior bonds given the lower associated funding cost. The primary objects and purpose of a credit union remains the promotion of thrift among its members by the accumulation of their savings and the creation of sources of credit for their mutual benefit at fair and reasonable interest rates. It is the savings of credit union members (which can be withdrawn on demand) that will be invested by credit unions and this informs the appropriate level of investment risk that credit unions should be permitted to take and should inform credit unions in setting their own investment risk appetites. This will necessarily impact on the level of return that appropriate investment portfolios can generate. We therefore remain of the view that the change to the definition of bank bonds is appropriate.

The regulation making powers of the Central Bank afford flexibility to ensure that all regulations applicable to credit unions remain fit for purpose and proportionate. We keep all regulations under review on an ongoing basis and as indicated previously, we remain committed to undertaking a review two years post commencement of the amending investment regulations, to assess the impact which the changes have had on credit union investment portfolios.

The Central Bank believes that the amendments being made to the regulations introduce important and significant changes to the investment framework for credit unions including the introduction of three new investment classes and the important changes to the liquidity requirements which were informed by feedback received as part of the consultation process.

Appendix 1: Draft Credit Union Act 1997 (Regulatory Requirements) (Amendment) Regulations 2018

STATUTORY INSTRUMENTS.

S.I. No. of 2018

CREDIT UNION ACT 1997 (REGULATORY REQUIREMENTS) (AMENDMENT) REGULATIONS 2018

S.I. No. of 2018

CREDIT UNION ACT 1997 (REGULATORY REQUIREMENTS) (AMENDMENT) REGULATIONS 2018

In exercise of the powers conferred on the Central Bank of Ireland (the "Bank") by section 182A of the Credit Union Act, 1997 (No. 15 of 1997) (the "Act"), the Bank, having consulted the Minister for Finance, the Credit Union Advisory Committee and other bodies that appear to the Bank to have expertise or knowledge of credit unions generally and that the Bank considers appropriate to consult in the circumstances, hereby makes the following regulations:

1. (1) These Regulations may be cited as the Credit Union Act 1997 (Regulatory Requirements) (Amendment) Regulations 2018.

(2) These Regulations come into operation on 1 March 2018.

2. In these Regulations "Principal Regulations" means the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (S.I. No. 1 of 2016).

3. Regulation 2(1) of the Principal Regulations is amended –

(a) by substituting for the definition of "bank bonds" the following definition:

""bank bond" means a senior bond issued by a credit institution and traded on a regulated market where the capital amount invested is guaranteed by the issuer and, for the avoidance of doubt, does not include any bond that is subordinated to any other liability of that credit institution;",

(b) by deleting the definition of "collective investment schemes", and

(c) by inserting the following definitions:

""approved housing body" means a housing body granted approval status under section 6 of the Housing (Miscellaneous Provisions) Act, 1992;

"corporate bond" means a bond issued by a company and traded on a regulated market excluding the following:
(a) a bond issued by a credit institution;
(b) a bond issued by a holding company of a credit institution;

"credit rating" has the same meaning as it has in Article 3(1)(a) of Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of 16 September 2009[14] on credit rating agencies;

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[14]OJ No. L302, 17.11.2009, p. 1

"holding company" means a company whose business consists wholly or mainly of the holding of shares or securities of other companies;

"recognised rating agency" means a credit rating agency that is registered or certified in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009[15] on credit rating agencies;

"supranational bond" means a bond issued by a supranational institution, being an institution formed by two or more central governments with the purpose of promoting economic development for the member countries;

"Tier 3 Approved Housing Body" means a housing body granted approval status under section 6 of the Housing (Miscellaneous Provisions) Act, 1992 and classified as Tier 3 under the Voluntary Regulation Code for Approved Housing Bodies in Ireland;

"UCITS" means an undertaking authorised as an undertaking for collective investment in transferable securities by the Bank or by a competent authority of another EEA State pursuant to Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009[16] on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS);".

4. The Principal Regulations are amended by substituting for Part 3 the following –

"Interpretation – Part 3

7. (1) In this Part "relevant liquid assets" means the following unencumbered assets only:

(a) cash;

(b) investments with a maturity of less than 3 months, excluding the minimum reserve deposit account and the deposit protection account;

(c) Irish and EEA State Securities, bank bonds and supranational bonds with a maturity of greater than 3 months, held either directly or through a UCITS, provided that all such Irish and EEA State Securities and supranational bonds comply with the minimum rating requirements specified in Regulation 29(1) or 29(3).

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[15]OJ No. L302, 17.11.2009, p. 1
[16]OJ No. L302, 17.11.2009, p. 32

(2) For the purposes of calculating the minimum liquidity ratio specified in Regulation 8(1), the following discounts shall be applied in valuing the relevant liquid assets specified in paragraph (1)(c):

(a) where such investments have a maturity of greater than three months and less than one year, a 10 per cent discount shall be applied to the market value of such investments;

(b) where such investments have a maturity of at least one year but less than 5 years, a 30 per cent discount shall be applied to the market value of such investments;

(c) where such investments have a maturity of at least 5 years and up to 10 years, a 50 per cent discount shall be applied to the market value of such investments.

Liquidity Requirements

8. (1) A credit union shall establish and maintain a minimum liquidity ratio of relevant liquid assets of at least 20 per cent of its unattached savings, subject to the following:

(a) at least 2.5 per cent of unattached savings shall be comprised of cash and investments with a maturity of less than 8 days;

(b) no more than 10 per cent of unattached savings shall be comprised of the relevant liquid assets specified in Regulation 7(1)(c), after application of the applicable discounts specified in Regulation 7(2).

Reporting Requirements

9. (1) A credit union shall monitor its liquidity ratio on a continuous basis to ensure compliance with the liquidity requirements in this Part and in the Act.

(2) Where a credit union is failing, or likely to fail to comply, with the liquidity requirements in this Part or in the Act, it shall notify the Bank in writing no later than close of business on the next business day.”.

5. The Principal Regulations are amended by substituting for Part 5 the following –

“*Classes of Investments*

25. (1) A credit union may only invest in euro denominated investments in the following:

(a) Irish and EEA State Securities;

(b) supranational bonds;

(c) accounts in credit institutions;

(d) bank bonds;

(e) corporate bonds;

(f) regulated investment vehicles where the underlying investments of the regulated investment vehicle are investments in Tier 3 Approved Housing Bodies;

(g) UCITS;

(h) shares of, and deposits with, other credit unions;

(i) shares of a society registered under the Industrial and Provident Societies Act 1893 to 1978, provided the society is not an approved housing body.

(2) For the purposes of Regulation 25(1)(f), the underlying investments of a regulated investment vehicle in a Tier 3 Approved Housing Body shall consist exclusively of loans or other forms of debt financing provided by the regulated investment vehicle to the Tier 3 Approved Housing Body.

(3) A credit union may invest in a UCITS only where –

(a) the underlying investments of the UCITS are composed of instruments specified in Regulation 25(1)(a), (b), (c), (d) or (e) (or any combination of such instruments),

(b) the UCITS has total assets with a value of at least €150 million, and

(c) the making of such an investment would not cause a credit union to fail to comply with this Part.

(4) The Bank may prescribe from time to time, in accordance with section 43 of the Act, further classes of investments in which a credit union may invest its funds which may include investments in projects of a public nature. Investments in projects of a public nature include, but are not limited to, investments in social housing projects.

Counterparty Limits

26. (1) A credit union shall not make an investment with a counterparty which, were that investment to be made, would cause the credit union's investments with that counterparty to

exceed 20 per cent of the credit union's total value of investments.

(2) A credit union shall not make a direct investment in corporate bonds issued by a particular counterparty which, were that investment to be made, would cause the credit union's direct investments in corporate bonds issued by that counterparty to exceed 5 per cent of the total value of the credit union's regulatory reserve.

Concentration Limits

27. (1) A credit union shall not make an investment in Irish and EEA State Securities, either directly or through a UCITS, which would cause the credit union's combined investments in Irish and EEA State Securities and supranational bonds, held directly or through a UCITS, to exceed 70 per cent of the total value of the credit union's investments.

(2) A credit union shall not make an investment in supranational bonds, either directly or through a UCITS, which would cause the credit union's combined investments in Irish and EEA State Securities and supranational bonds, held directly or through a UCITS, to exceed 70 per cent of the total value of the credit union's investments.

(3) A credit union shall not make an investment in bank bonds, either directly or through a UCITS, which would cause the credit union's investments in bank bonds, held directly or through a UCITS, to exceed 70 per cent of the total value of the credit union's investments.

(4) A credit union shall not make an investment in corporate bonds, either directly or through a UCITS, which would cause the credit union's investments in corporate bonds, held directly or through a UCITS, to exceed 50 per cent of the credit union's regulatory reserve.

(5) A credit union shall not make an investment in a regulated investment vehicle referred to in Regulation 25(1)(f) which would cause the credit union's investments in such regulated investment vehicles to exceed –

(a) 50 per cent of the credit union's regulatory reserve, where the credit union has assets of at least €100 million, or

(b) 25 per cent of the credit union's regulatory reserve, where the credit union has assets of less than €100 million.

(6) A credit union shall not make an investment in another credit union which would cause the credit union's investments in other credit unions to exceed 12.5 per cent of the credit union's regulatory reserve.

(7) A credit union shall not make an investment in the shares of a society referred to in Regulation 25(1)(i) which would cause the credit union's investments in shares in societies referred to in Regulation 25(1)(i) to exceed 12.5 per cent of the credit union's regulatory reserve.

Maturity Limits

28. (1) With the exception of an investment in a regulated investment vehicle referred to in Regulation 25(1)(f), a credit union shall not make an investment, either directly or through a UCITS, which has a maturity date which exceeds 10 years from the date of the investment.

(2) A credit union shall not make an investment in a regulated investment vehicle referred to in Regulation 25(1)(f) where the underlying investments of that regulated investment vehicle have a maturity date which exceeds 25 years from the date of the investment.

(3) A credit union shall not make an investment which would cause the credit union to have more than 30 per cent of its investments maturing after 7 years.

(4) A credit union shall not make an investment which would cause the credit union to have more than 50 per cent of its investments maturing after 5 years.

Minimum Rating Requirements

29. (1) A credit union may invest directly in –

(a) Irish and EEA State Securities, or

(b) supranational bonds,

only where at least two recognised rating agencies have assigned to those investments a credit rating of investment grade or higher.

(2) A credit union may invest in corporate bonds directly only where at least two recognised rating agencies have assigned to each such investment a credit rating that is at least equivalent to an A3 rating on the rating scale issued by Moody's Investor Service.

(3) A credit union may invest in UCITS where the underlying investments of the UCITS are composed of –

(a) Irish and EEA State Securities,

(b) supranational bonds, or

(c) corporate bonds,

only where at least one recognised rating agency has assigned to each such underlying investment of the UCITS a credit rating of investment grade or higher.

(4) Subject to Regulation 33(2), where an investment made by a credit union no longer complies with the minimum rating requirements specified in paragraph (1), (2) or (3), a credit union shall divest itself of that investment as soon as possible.

Holding of Investments

30. A credit union shall ensure that any investments made remain in compliance with the investment requirements in this Part.

Investment Practices – Distribution of Investment Income/ Investment Gain

31. A credit union shall not distribute from its annual operating surplus, investment income or an investment gain to members or transfer investment income or an investment gain to a reserve set aside to provide for dividends, unless the investment income or investment gain falls within the following:

(a) investment income or an investment gain received by the credit union at the balance sheet date;

(b) investment income that will be received by the credit union within 12 months of the balance sheet date.

Investment Practices – Concentration Risk

32. A credit union shall establish and maintain a written strategy having regard to section 43 of the Act to manage concentration risk which can result from dealing with a single counterparty or holding investments with similar characteristics like maturities and to ensure investments remain within the limits contained in these Regulations.

Transitional Arrangements

33. (1) Where, on 1 March 2018, a credit union has investments made in accordance with legislative requirements applicable at the time of the investment which do not comply with the requirements in this Part, the credit union shall (subject to paragraph (2)):

(a) take such actions as are necessary in relation to those investments in order to ensure compliance with this Part –

(i) as soon as possible without incurring a loss, and

(ii) in any event not later than 1 March 2020 or such later date as the Bank may permit;

(b) only make an investment where the making of such an investment would not cause the credit union to either -

(i) fail to comply with any of the requirements in this Part, or

(ii) exacerbate a failure existing on 1 March 2018 to comply with any of the requirements in this Part.

(2) A credit union may hold to maturity all fixed term investments made in accordance with legislative requirements applicable at the time of the investment and held by that credit union on 1 March 2018.”.

Signed for and on behalf of the CENTRAL BANK OF IRELAND

on [insert date]

PATRICK CASEY,
Registrar of Credit Unions

EXPLANATORY NOTE

(This note does not form part of the Instrument and does not purport to be a legal interpretation)

The purpose of these Regulations is to amend the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (S.I. No. 1 of 2016).

Appendix 2: Comparison Tables

Investments

Area	2016 Regulations	Requirements in amending regulations
Irish and EEA state securities:	**Maturity:** 10 years	**Maturity:** 10 years
	Credit Rating: n/a	**Credit Rating:** Investment Grade
	Concentration Limit: 70% of Investment portfolio	**Concentration Limit:** combined limit of 70% of Investment portfolio for Irish and EEA state securities and Supranational bonds
Supranational bonds:	Not a permitted investment class	**Maturity:** 10 years
		Credit Rating: Investment Grade
		Concentration Limit: combined limit of 70% of Investment portfolio for Irish and EEA state securities and Supranational bonds
Senior Bank Bonds:	**Maturity:** 10 years	**Maturity:** 10 years
	Credit Rating: n/a	**Credit Rating:** n/a
	Concentration Limit: 70% of Investment portfolio	**Concentration Limit:** 70% of Investment portfolio
Corporate Bonds:	Not a permitted investment class	**Maturity:** 10 years
		Credit Rating: 'A' rating for direct investments. Investment Grade for investment through a UCITS

Area	2016 Regulations	Requirements in amending regulations
		Concentration Limit: 50% of Regulatory Reserves **Counterparty Limit**: 5% of Regulatory Reserves for a direct investment in a corporate bond
Tier 3 Approved Housing Bodies through an investment vehicle:	Not a permitted investment class	**Maturity:** 25 years
		Concentration Limit: 25% of Regulatory Reserves for credit unions with total assets of less than €100m 50% of Regulatory Reserves for credit unions with total assets of at least €100m
Accounts in Authorised Credit Institutions:	Permitted class of investment	Permitted class of investment
Collective investment schemes:	The investment schemes comprise the following instrument types:	UCITS investment schemes comprising the following instrument types:
	a) Irish and EEA state Securities	a) Irish and EEA state Securities
	b) Bank Bonds	b) Bank Bonds
	c) Accounts in Authorised Credit Institutions	c) Accounts in Authorised Credit Institutions
		d) Supranational bonds
		e) Corporate Bonds
Other credit unions:	**Concentration Limit:** 12.5% of Regulatory Reserves	**Concentration Limit:** 12.5% of Regulatory Reserves
Industrial and Provident Societies:	**Concentration Limit:** 12.5% of Regulatory Reserves	**Concentration Limit:** 12.5% of Regulatory Reserves

Other Investment Requirements

Area	2016 Regulations	Requirements in amending regulations
Counterparty limit – investments in single institution	25% of total investments	20% of total investments 5% of Regulatory Reserves for a direct investment in a corporate bond
Currency Requirement	Investment limited to EURO investments	Investment limited to EURO investments
Overall Portfolio Maturity limits	Investments maturing after 5 years – 50% of investment portfolio	Investments maturing after 5 years – 50% of investment portfolio
	Investments maturing after 7 years – 30% of investment portfolio	Investments maturing after 7 years – 30% of investment portfolio

Liquidity

Area	2016 Regulations	Requirements in amending regulations
Short term liquidity ratio	Short term liquidity ratio of 5% of unattached savings	2.5% of unattached savings (now included in the minimum liquidity ratio)
Minimum liquidity ratio	Minimum liquidity ratio of 20% of unattached savings	Minimum liquidity ratio of 20% of unattached savings
Composition of Minimum liquidity ratio	n/a	(a) at least 2.5% of unattached savings comprised of cash and investments with a maturity of less than 8 days (b) no more than 10% of unattached savings may be composed of allowable liquid bonds (after application of required discounts)
Relevant liquid assets	1) Cash	1) Cash
	2) Investments with a maturity of less than 3 months excluding the minimum reserve deposit account and the deposit protection account	2) Investments with a maturity of less than 3 months excluding the minimum reserve deposit account and the deposit protection account
	3) Investments with a maturity of 3 months or more, excluding the minimum reserve deposit account and the deposit protection account where a written guarantee exists to the effect that funds are available to the credit union in less than 3 months.	3) Irish and EEA state securities, bank bonds and supranational bonds with greater than 3 months to maturity with the associated discount applied to the market value (this discount is dependent on the remaining time to maturity of the investment).
	Notification to Central Bank where fail to meet liquidity requirements	Notification to Central Bank where fail to meet liquidity requirements

Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem