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Credit Union Investments

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Background – Investment Framework for Credit Unions

- Section 43 of the 1997 Act sets out provisions relating to credit unions' investment of surplus funds. Section 43(1) of the 1997 Act requires that a credit union '***shall manage its investments to ensure that those investments do not (taking account of the nature, scale, complexity and risk profile of the credit union) involve undue risk to members' savings and, for that purpose, before making an investment a credit union shall assess the potential impact on the credit union, including the impact on the liquidity and financial position of the credit union.***'
- Under section 43(3) of the 1997 Act, the Central Bank may prescribe investments in which a credit union may invest its surplus funds.
- The list of permissible classes of investments and associated limits set out in the 2016 Regulations reflect our statutory mandate towards credit unions as it relates to the protection by credit unions of the funds of their members and the requirements under section 43 of the 1997 Act.
- **2017 Review** – Following review, three new investment classes (***Supranational bonds, Corporate bonds*** and ***investments in Tier 3 Approved Housing Bodies (AHBs)***) were introduced in March 2018, accompanied by the introduction of specified credit quality, maturity and concentration limits for these investment classes.
- **2020 Changes** – Further changes relating to investments and liquidity were made in 2020 to facilitate holding of investments in UK credit institutions that would have become non-compliant post Brexit and to formally extend the definition of liquid assets to include excess balances in minimum reserve accounts.

Background

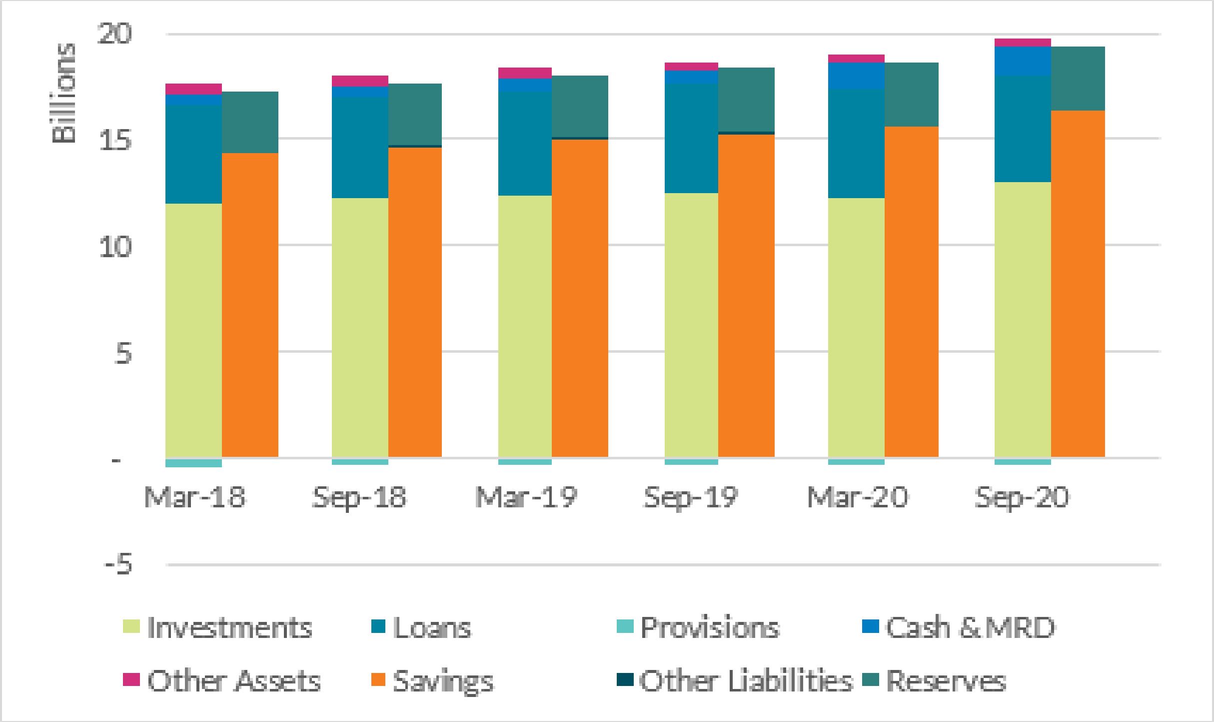
- Report on Credit Union Investments published on 15 September.
- Purpose of report:
  - to set out analysis undertaken to assess the impact of changes introduced in 2018 to the investment regulations on credit union investment portfolios; and
  - set out our supervisory expectations for credit unions on investments.
- The report provides analysis which has been informed by data provided by credit unions in responses to a questionnaire issued in September 2020 and quarterly Prudential Return data.
- The analysis set out in the report highlights themes and trends in credit union investments, including the level of utilisation of the new investment classes introduced in 2018.

Overview of Analysis – Total Investments

- ***Total investments have grown over the review period by €1bn, from €12bn to €13bn***, reflecting savings inflows and the low sector loan to asset ratio.

- Investments represent a significant portion of assets in the credit union sector – standing at 67% as at 30 September 2020.

Chart 1 | Balance Sheet Trends



Source: PR Data submitted to RCU
Note: 'Cash & MRD includes cash & current accounts, deposit protection account and minimum reserve deposit held.

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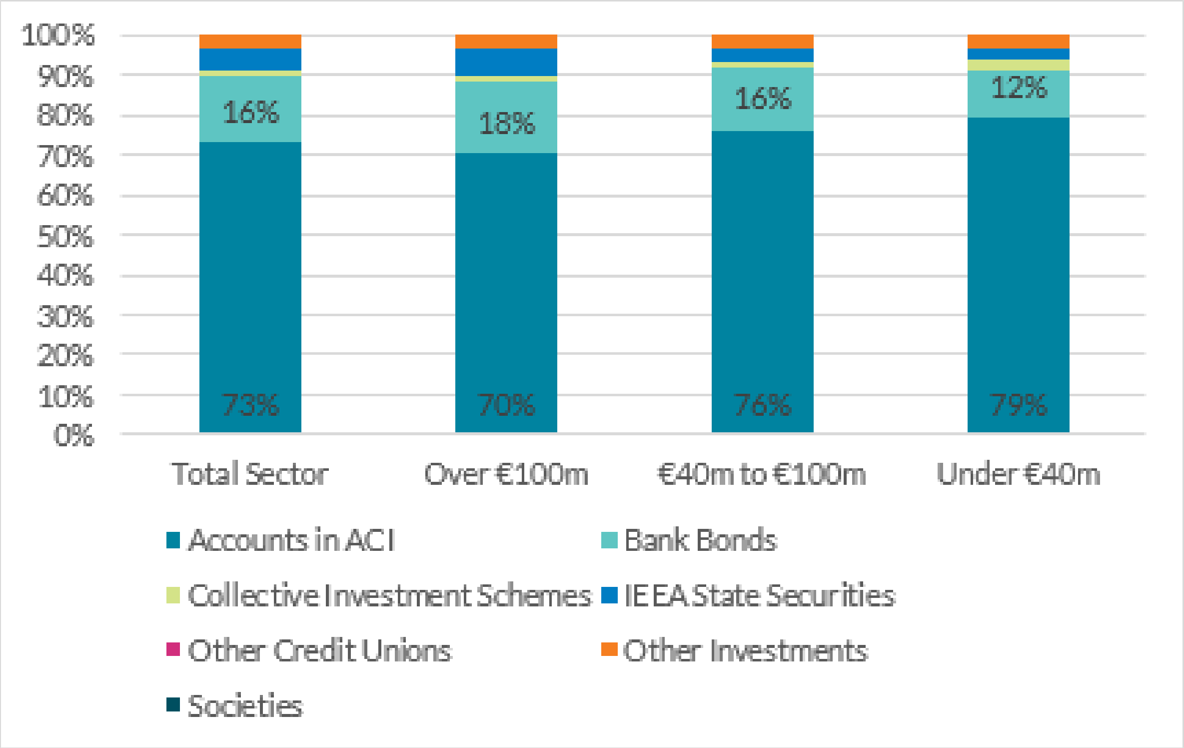
Overview of Analysis – Investment Classes

- Credit unions have ***continued to focus on traditional investment classes*** with the majority of investments (74%) continuing to be held in accounts in authorised credit institutions.

- Majority of investments held in accounts in authorised credit institutions are held in 'traditional deposits', with 87% of accounts in authorised credit institutions reported to be 'basic deposit accounts' and 13% reported to be 'tracker type deposit products'.

Chart 2 | Total Investments by Category March 2018



Source: PR Data submitted to RCU

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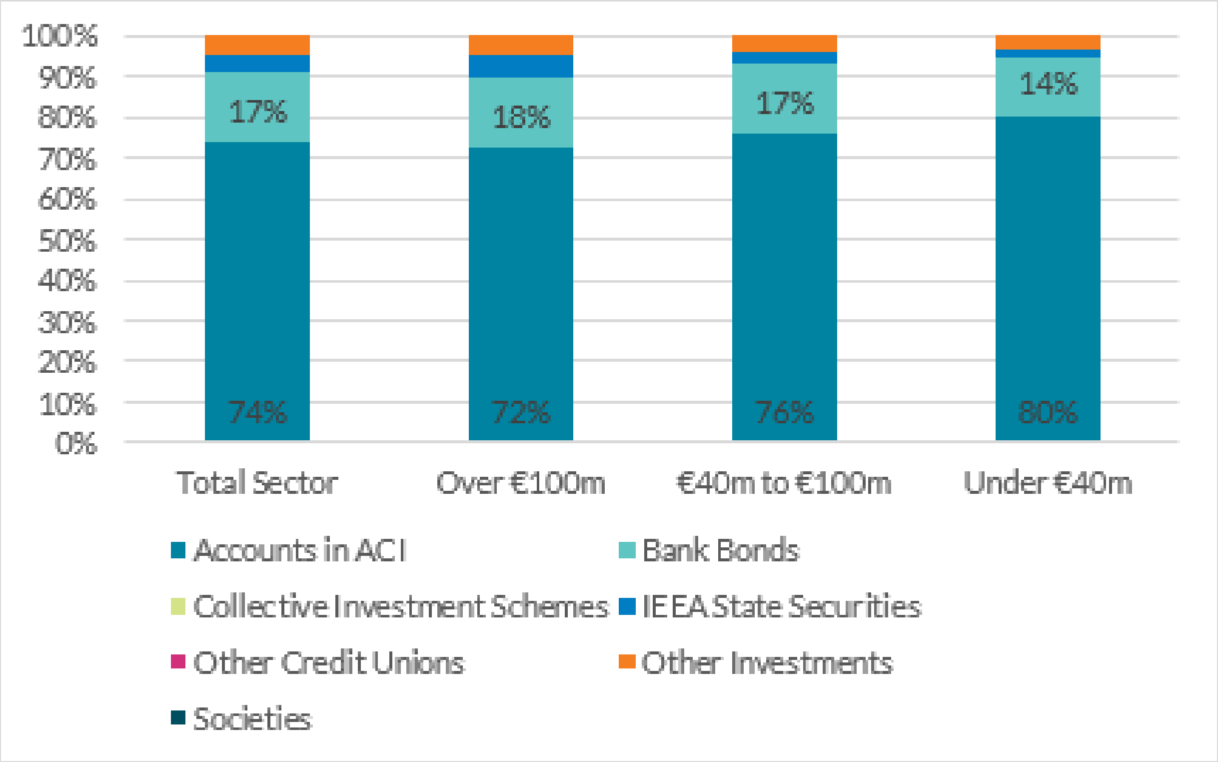
Overview of Analysis – Bank Bonds & Irish & EEA State Securities

- Bank bonds are the second most significant investment category for credit unions, representing 17% of credit union total investments at 30 September 2020.

- Investments in Irish and EEA State Securities represented 5% of investments at 30 September 2020, unchanged from 31 March 2018.

Chart 3 | Total Investments by Category September 2020



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Overview of Analysis – New Investment Classes

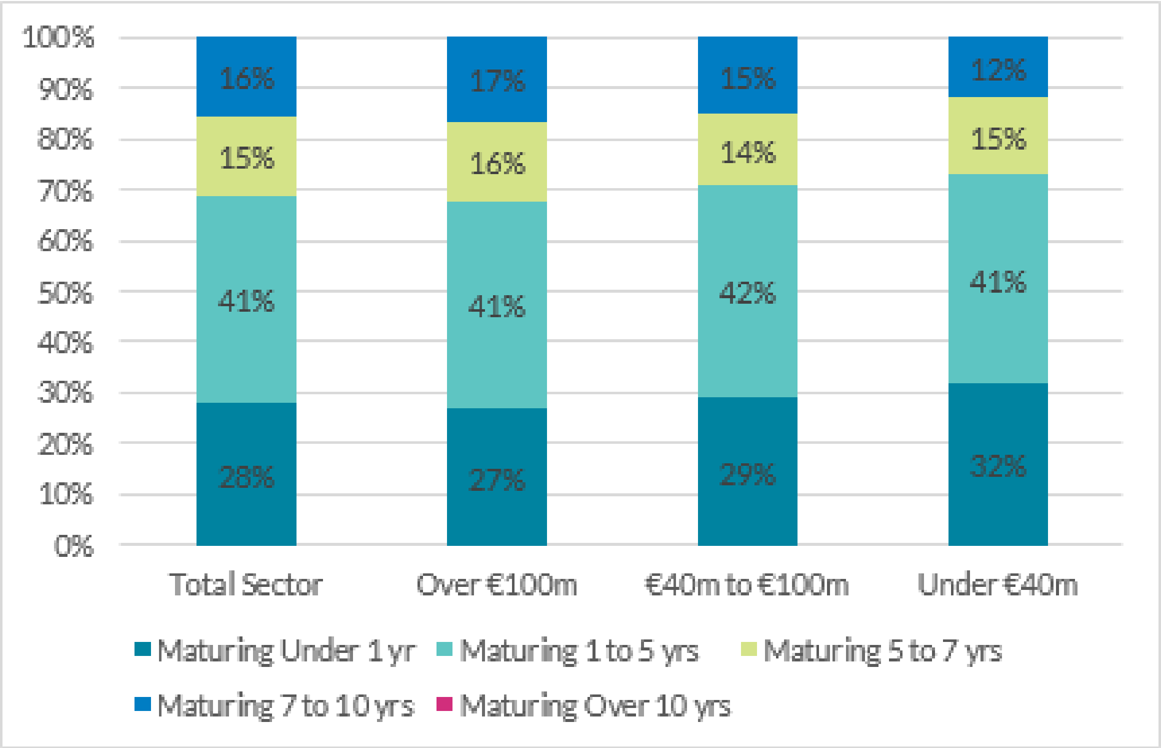
- Analysis demonstrated limited investment in new investment classes with ***no investments reported in Tier 3 Approved Housing Bodies (AHBs)*** and ***very small weightings to Supranational and corporate bonds*** (0.01% and 0.19% respectively).
- It has taken time to establish regulated investment vehicles to facilitate credit union investments in Tier 3 AHBs. However, we are aware that work on establishing such structures has now progressed – will facilitate investments by credit unions in Tier 3 AHBs.
- In relation to ***supranational bonds***, low returns, reflecting the current low interest rate environment, may have been a factor in the lack of credit union investment in this class of investment to date.
- There has also been a low level of investment in ***corporate bonds*** via direct investment in individual bonds. Low levels of investments are likely to be a reflection of current relatively low yields on this type of investment, with only limited additional return available versus more traditional credit union investments.
- As at 30 September 2020, there was ***no investment in corporate bonds via UCITS***. However, since then we are aware that work has progressed on at least one UCITS fund initiative, which has reached the required minimum size threshold of €150m. This now provides credit unions with a mechanism to invest in corporate bonds via a UCITS structure.

Overview of Analysis – Maturity Profile of Investments

- There has been a significant shift in the maturity profile of investments with investments with a maturity of greater than 5 years increasing from 16% of total credit union investments at 31 March 2018 to 31% at 30 September 2020.

- Over the same period the proportion of investments with a maturity of less than 1 year has decreased from 42% of total investments at 31 March 2018 to 28% at 30 September 2020.

Chart 5 | Maturity Profile of Investments September 2020



Source: PR Data submitted to RCU

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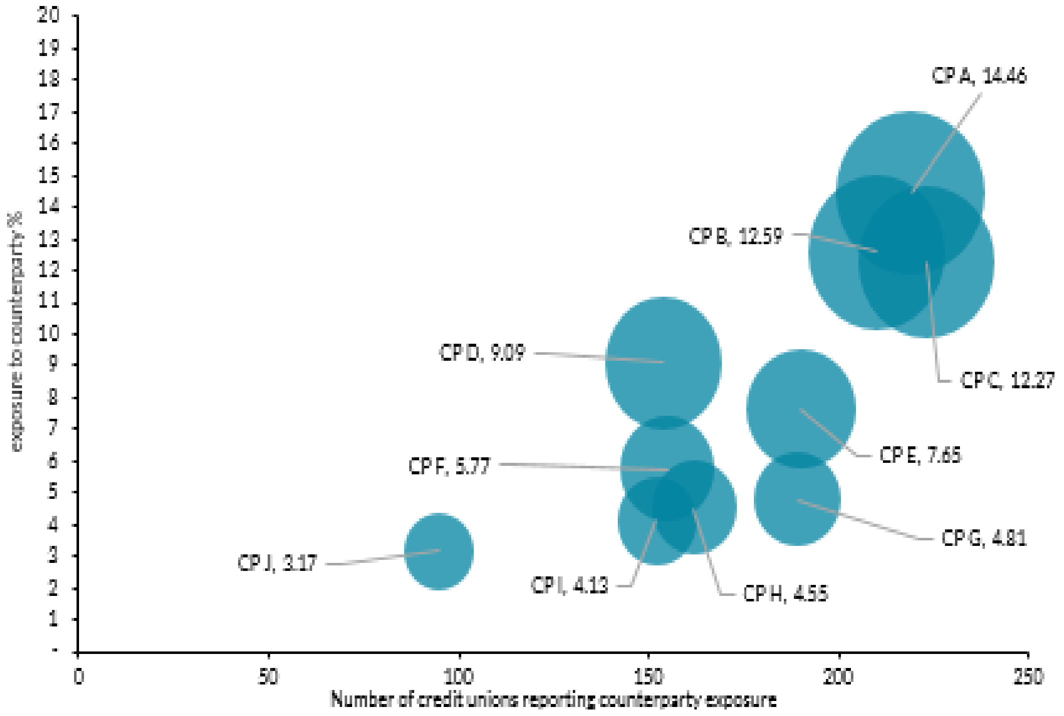
Overview of Analysis – Counterparties

- Credit unions invest in a wide range of counterparties – with over 70 different investment counterparties identified on the Questionnaire.

- While there are a broad range of counterparty options available, a large proportion of overall credit union investments continue to be held with a relatively small number of counterparties with a reduced but remaining concentration in the Irish retail banking system.

- The level of counterparty concentration has fallen since March 2018 – 56% of credit union investments are held across 5 counterparties down from 62%.

Chart 7 | Investment Counterparties September 2020



Source: Investment Questionnaire data submitted to RCU

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Conclusions of Report

- Analysis indicates that, while to date, the 2018 changes to the investment framework have had limited impact on credit union investments, recent developments on a number of initiatives should facilitate increased usage of the investment classes introduced in 2018 – if credit unions so decide to avail of capacity to invest in these investment classes. We will continue to monitor the level of investments by investment class across the sector via returns submitted by credit unions.

- We remain of the view that the investment classes and limits as prescribed in the 2016 Regulations, including the new investment classes and limits introduced in 2018, continue to provide an appropriate range of investment choices and diversification opportunities for credit unions, taking account of the requirements under section 43 of the 1997 Act and individual credit unions' own investment risk appetites.

Supervisory Expectations

- Notable that some of the trends in credit union investment portfolios since March 2018 may evidence a shift in credit union investment risk appetite, which may be driven by the low interest rate environment.

Investment trends and risk appetite

- Investment decisions must reflect appropriate levels of investment risk for credit unions consistent with the requirements under section 43 of the 1997 Act.

- Investment decisions should reflect the objects of credit unions and the fact that it is the savings of credit union that are being invested – credit unions' investment risk appetite and the risk profile of investment portfolios should reflect this.

- The primary objects and purpose of a credit union is 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.

- **The overriding consideration in making investments must be the protection by credit unions of the funds of their members**.

Supervisory Expectations

Credit Union Investment Decisions

- Credit unions should ensure that detailed analysis and careful consideration is undertaken before making any investment decisions to ensure associated risks are fully understood and considered.
- Careful consideration should be given to any potential shift in the risk profile of a credit union's investment portfolio including an extension in the maturity profile or the introduction of new counterparties.
- Changes to the maturity profile of the investment portfolio should be considered in the context of broader asset and liability management including liquidity considerations.
- Where a credit union is introducing a new counterparty into the investment portfolio they should undertake appropriate due diligence to ensure:
  - clarity on which counterparty they would be exposed to,
  - counterparty complies with the investment regulations; and
  - risk profile of any new counterparty is understood so they can ensure that this aligns to investment risk appetite .