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DAVY

The Central Bank of Ireland's Consultation on the Introduction of a Tiered Regulatory Approach for Credit Unions (CP 76)

Assessing the Impact on Credit Union Investments

MARCH 2014

CONTENTS

This paper is intended to provide a summary of the potential impact of certain proposals contained within the Central Bank of Ireland's Consultation on the Introduction of a Tiered Regulatory Approach for Credit Unions ('Consultation Paper 76' or 'CP76' or 'Consultation' or the 'Paper'). It is provided for information and discussion purposes only and is not intended to be comprehensive. It focuses on the investment aspects of the Consultation Paper exclusively. Readers should supplement the content by reading the Consultation Paper and form their own view in relation to the investment aspects and any other points that may be relevant to their credit union. Statements and other assumptions contained in this paper are based on the current expectations, opinions and/or beliefs of Davy at the time of publishing. These assumptions and statements may or may not prove to be correct and actual outcomes may differ.

Executive Summary

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- The Report of the Commission on Credit Unions (2012) recommended, among other things, that the regulatory framework should be strengthened for credit unions and that this framework should include a tiered structure.
- In 2013, the Central Bank of Ireland (the 'Central Bank') began the process of implementing a new framework which features enhanced governance, risk management systems and a fitness and probity regime for credit unions.
- In December 2013, the Central Bank published a consultation paper ('CP76') which is seeking input from the movement and its stakeholders on proposed activities and services, including lending and investments that it proposes be undertaken within a tiered structure. Based on initial analysis, the proposals, if implemented, are likely to have far-reaching implications for the movement's savings, loans and investments. This paper focuses almost exclusively on the implications for investments.
- Investment income is likely to be adversely affected and growth in general may be inhibited as a result. In addition and due to the introduction of reduced counterparty limits, there is potential for significant deposit outflows from the Irish banking system.
- Davy has conducted preliminary testing of the proposals across a number of investment portfolios from a sample of 83 individual credit union balance sheets incorporating a sample size of approximately 39% of total movement assets (€5.4 billion) and approximately 38% of surplus funds (€3.7 billion)[1]. Davy intends to use the results of this analysis as the basis for a submission to the Central Bank which will feature constructive recommendations.
- We urge every credit union to review the proposals contained within the consultation and to give due consideration to making individual submissions to the Central Bank before the closing date of 31st March 2014.

PLEASE NOTE: Until the consultation process concludes and a new investment framework is fully implemented, there is no certainty that the proposals set out in the Consultation Paper will materialise. Actual outcomes may differ.

1 Please refer to Appendix 1 for additional details on the sample of credit unions used by Davy.

Section 1: Introduction & Background

Introduction

The Central Bank of Ireland (the 'Central Bank') published a consultation paper on the introduction of a tiered regulatory approach for credit unions ('CP76') in December 2013. As outlined, the proposals are likely to have far-reaching implications for the movement's savings, loans and investments. Therefore, Davy highly recommends that your credit union reviews and gives consideration to the proposals contained within the consultation.

In particular, if the proposals in relation to investments are implemented in their current form, they are likely to have considerable implications for investment portfolios and their management henceforth. The purpose of this paper is to raise awareness of the main features of the proposed investment limits and to highlight the significant impact that the proposals are likely to have if implemented on, among other things, investment income.

Background

This consultation process is the first step[2] towards adopting a tiered regulatory approach for credit unions as recommended by the Report of the Commission on Credit Unions (2012)[3]. The Central Bank has taken account of certain recommendations of the Commission's report, made modifications where it deemed appropriate and proposed a new tiered regulatory framework within the consultation paper. A two-category approach is suggested[4], which is in contrast to the three-tier structure as advocated by the Commission. The intention is that Category 1 credit unions would offer services comparable to those currently being offered. Credit unions that are capable of and wish to undertake a wider range of activities and services could apply to become a Category 2 credit union. Category 2 credit unions may invest in a wider range of assets and longer dated investments than Category 1 credit unions.

In reviewing the proposed approach adopted by the Central Bank, due consideration should be given to factors such as the timing of the proposals and the current landscape within which credit unions are operating. Credit unions in Ireland are facing the most challenging environment in their history:

- arrears remain elevated;
- loans continue to decline, having fallen by 11% from September 2012 resulting in an average loan to asset ratio of just 33%[5];
- it is extremely difficult for credit unions to generate investment income in the current record low interest rate environment and as the effects of banks' classification of credit unions under Basel III[6] depress cash deposit rates; and
- credit unions are undergoing huge change as the regulatory framework transforms to include a robust fitness and probity regime, strengthened governance and heightened supervision.

Consideration should also be given to appropriate diligence to assess the impact of the proposed approach on credit unions. We are not aware of any testing of the existing regulatory investment framework nor were we able to source models of the proposals. However, we note that the second stage of the consultation process involves a Regulatory Impact Analysis. This analysis should include testing of the current framework so that any shortcomings and potential risks are clearly identified. Furthermore, it is imperative that the analysis evaluates the commercial impact of the proposed changes on credit unions and their viability. If the framework is overly restrictive or sufficient impact analysis is not conducted, we believe that it could pose a threat to the viability of certain credit unions.

2 Please refer to Appendix 2 for more detail on the consultation process and the timetable.
3 https://www.rebo.ie/images/documents/creditunionrepmar2012.pdf
4 Please refer to Appendix 3 for further detail.
5 http://www.centralbank.ie/press-area/speeches/Pages/AddressbyRegistrarofCreditUnionsSharonDonneryCUDAAGM.aspx
6 Basel III introduces new liquidity ratios called the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratios (NSFR). These ratios are being implemented in the EU via the Capital Requirements Directive IV. Essentially, the ratios force banks to classify deposits according to their perceived stability. Credit union deposits are currently classified in the most penal category which means that they are no longer as attractive to banks, and this is reflected in reduced deposit rates available to credit union funds.

Section 2: Main Features of the Proposals on Investments[7]

i. A more limited subset of authorised investment classes: Currently, credit unions may invest in securities as authorised under the Trustee (Authorised Investments) Order 1998. In addition, credit unions must adhere to the authorised classes and limits as prescribed by the Central Bank. The Central Bank's Guidance Note on Investments by Credit Unions (2006)[8] (the 'GN') authorises credit unions to invest in five separate investment classes. Under the proposed measures the investment classes will be reduced to just three for the majority of credit unions, who are likely to be classified as Category 1:

- All credit unions (i.e. both Category 1 and 2) may invest in certain bank deposits[9], government bonds[10], and shares/deposits of other credit unions.
- Category 2 credit unions may also invest in certain senior unsecured bank bonds[11] and corporate bonds[12].
- Investments in equities (Class 4 of the GN) are no longer proposed as an authorised investment class.
- Collective investment schemes (Class 5 of the GN) are no longer proposed as an authorised investment class.

ii. Counterparty limits relate to regulatory reserves rather than a percentage of the investment portfolio:

- It is proposed that investments in a single counterparty other than a credit union (i.e. bank or EEA state) can be up to 100% of a credit union's Regulatory Reserves.
- This is likely to reduce counterparty exposure to well below the current limit of 25% of the investment portfolio.

iii. The introduction of short-term liquidity constraints: In addition to the minimum liquidity ratio of 20%, short-term liquidity requirements will apply:

- At least 10% of unattached savings must be available in up to seven days; and
- Up to 15% of unattached savings must be available within one month.

iv. No minimum credit ratings: No minimum credit ratings are proposed in relation to government bonds, cash deposits or senior unsecured bank bonds.

v. Maximum maturity limits: Maturity limits of investments are reduced from 10 years currently to 5 years for Category 1 credit unions. For Category 2 credit unions, maturity limits of cash deposits and senior bank bonds / corporate bonds are reduced from 10 years currently to 7 years, and the maturity limit of 10 years for government bonds is maintained.

vi. Maturity exposures limits are at portfolio level rather than asset class level: Under the original GN, there are exposure limits to longer dated maturities at asset class level. For example, credit unions may not hold more than 30% of government bonds which are maturing after 7 years. The consultation proposes limits at portfolio level. Category 1 credit unions cannot hold more than 50% of the portfolio maturing after 3 years while Category 2 credit unions cannot hold more than 50% of the portfolio in investments maturing after 5 years.

vii. Asset class concentration limits are related to reserves: Asset class concentration limits are no longer expressed as a percentage of the investment portfolio but rather of Regulatory Reserves. Category 2 credit unions may invest up to 50% of their Regulatory Reserves in bank bonds, and up to 50% of their Regulatory Reserves in certain corporate bonds. Based on initial analysis, we estimate that 50% of Regulatory Reserves translates to approximately 9% of the total investment portfolio, which is a restrictive limit for senior bank bond investments and in stark contrast to the limit under the GN, under which up to 70% of the investment portfolio may be allocated to bank bonds.

7 Please refer to Appendix 4 for a summary of the main features of the proposals on investments.
8 http://www.centralbank.ie/regulation/industry-sectors/credit-unions/Documents/200610%20-%20Guidance%20Note%20on%20Investments%20(amended%20for%20website).pdf
9 Bank deposits in an authorised credit institutions.
10 Irish and EEA State Securities.
11 Senior unsecured bonds issued by credit institutions authorised by the Central Bank or in any other EEA State.
12 Corporate bonds that are listed on a recognised exchange with a rating that is not lower than 'A' or its equivalent.

TABLE 1: Concentration limits

	Current Guidance	Proposed Limit
Investments in the shares and deposits of a single credit union (Category 1 and 2)	n/a	12.5% Regulatory Reserves
Total investments in bank bonds (Category 2)	70% of the investment portfolio	50% Regulatory Reserves *This translates to approximately 9% of the investment portfolio of the average credit union based on our sample*
Total investments in corporate bonds (Category 2)	n/a	50% Regulatory Reserves *This translates to approximately 9% of the investment portfolio of the average credit union based on our sample*

Source: Davy with reference to the Central Bank of Ireland's website

Section 3: Impact Analysis of the Proposals

In order to assess the impact of the proposals on credit union investments, we are in the midst of testing across a number of individual investment portfolios. For the purposes of illustration, we have identified a specific credit union portfolio[13] which we believe is a good representation of the average portfolio advised by Davy. We have tested the potential impact of the proposals on the credit union and our findings are significant. It should be noted that the implications for your credit union may differ considerably from those outlined below.

TABLE 2: Impact analysis on a sample credit union's investment portfolio

As all credit unions will be classified as Category 1 credit unions at the outset, the following analysis is based on the assumption that the sample credit union will be a Category 1 credit union. Certain credit unions may apply to transfer to Category 2; it is proposed that such credit unions will have asset sizes close to or above €100 million with other qualifying criteria yet to be outlined.

	Description	Current Allocation	% Portfolio
Investments which are not authorised under proposals	Government bonds (maturity > 5 years)	€3.5 million	4.89%
	Collective Investment Schemes	€3.8 million	5.20%
	Bank bonds	€4.2 million	5.77%
	Structured investments (bank bonds)	€3.08 million	4.19%
	Total	**€14.58 million will need to be allocated to cash deposits or short-term government bonds**	**20%**
	Counterparty	**€ Exposure > 100% Regulatory Reserves**	**Current Exposure as a % Regulatory Reserves**
Breaches of proposed counterparty limit of 100% regulatory reserves (€12.5 million which is approximately 17% of the investment portfolio)	BOI	€4.3 million	134% regulatory reserves
	PTSB	€4.9 million	140% regulatory reserves
	KBC Bank	€2.7 million	122% regulatory reserves
	Total	**€11.9 million will need to be allocated to alternative counterparties**	**16% of investment portfolio**
	Sources of liquidity	**€ Amount**	**% Total Liquidity**
Liquidity management: Credit unions will need to divert funds from collective investment schemes and access / step-up accounts[14] to call accounts or alternative liquid investments	Call accounts	€2.1 million	10.58%
	Term investments nearing maturity	€3.1 million	16.02%
	Collective Investment Schemes	**€3.8 million**	19.26%
	Access/Step-up accounts	**€10.7 million**	54.14%
	Total	**€14.5 million will need to be allocated to call accounts or alternative liquid investments**	
	Limit	**Current %**	**OK / Breach?**
Maturity limit	No more than 50% of the portfolio may mature after 3 years	25% investment portfolio	OK
Short-term Liquidity Constraints	At least 10% of unattached shares must be available 0-7 days	19% unattached shares	OK
	At least 15% of unattached shares must be available up to 1 month	21.3% unattached shares	OK

Source: Davy

Please note that there is no assurance that the assumptions referred to above will materialise. Actual outcomes may differ materially.

13 Please see Appendix 5 for background information on the sample credit union and their investment portfolio.

14 Please note that the requirement to divert funds from access accounts is likely to occur even in the absence of any changes to the investment framework.

Following on from the above analysis, we have identified a number of concerns with regards to the potential impact of the proposals:

i. The Impact on Investment Income

Our primary observation is that the proposed changes, as outlined, are likely to have an adverse impact on credit unions' investment income. This is at a time when it is already very difficult for credit unions to generate income. We believe that a number of credit unions may be relying on their investment returns in order to ensure sustainability in the current adverse economic environment. Investment income represented 41% of the total income generated by our sample of credit unions in the year ending 30th September 2013[15]. Davy anticipates that investment income will be adversely affected by the proposed investment limits for the following reasons:

a) Increased reliance on call deposits: Credit unions are likely to become more reliant on call deposit accounts which are yielding minimal returns. The average call rate available to credit unions from Irish banks[16] is 0.43% and we anticipate that this rate will drop further as the Irish banks fully implement Basel III liquidity ratios[17]. It is likely to move closer towards the average call rate of 0.14% that is currently available from non-Irish banks[18], which in the main have been more progressive in implementing Basel III. We can anticipate an increased reliance on call deposits for the following reasons:

- **Collective investment schemes:**
  - *The proposed exclusion of collective investment schemes as authorised investments may push credit unions into lower yielding call deposits in order to meet their liquidity requirements.*
  - *Class 5 collective investment schemes have served credit unions well as an effective means of managing liquidity, diversifying counterparty risk and ensuring that a meaningful return is achieved on liquid funds.*
  - *175 credit unions are currently invested in and have balances greater than €100,000 in Class 5 collective investment schemes[19] which are 100% deposit based and currently yielding around 1% variable (net of fees), which is in marked contrast to the call deposit rates outlined above.*
  - *As professionally managed funds which are subject to separate and rigorous independent regulation, the inclusion of unit trusts as an investment class brings an additional layer of regulatory supervision and therefore supports the objective of strengthening the investment framework.*
  - *We view it as unlikely that the credit union movement will achieve a new classification under the Basel III ratios of LCR and the NSFR. Cash-based unit trusts may therefore be one investment which may assist participating unit holders in mitigating some of the negative impact of Basel III.*
- **Access accounts are unlikely to be available in a Basel III investment world:**
  - *We estimate that credit unions are achieving approximately 50% of their required liquidity from access accounts, step up deposits or term deposits with one-off access features.*
  - *Such deposits offer attractive rates which mean that they generate attractive income while making an important contribution to credit union liquidity requirements.*
  - *Once banks have fully implemented Basel III liquidity ratios, access accounts will no longer be an attractive means of raising funding for banks and are highly unlikely to be available any longer. Therefore, credit unions will be more reliant on call deposit accounts in order to meet their liquidity requirements.*
  - *It should be stated that we anticipate that this trend will adversely affect credit unions' investment income regardless of any changes to the investment framework. However, the absence of collective investment schemes and the introduction of short-term liquidity constraints against this backdrop may exacerbate the negative impact on credit unions.*

15 Source: Davy
16 AIB, Bank of Ireland, EBS and Permanent TSB. Rates as at 6th February 2014.
17 Please refer to our paper 'Basel III Liquidity Standards: The Implications for Credit Union Investments', available at: www.davy.ie/credit-unions/basel
18 KBC Group, Danske Bank and Ulster Bank. Rates as at 6th February 2014.
19 Source: Davy, Prescient

b) **Lower yielding universe of authorised asset classes and investments:** We expect that the vast majority of credit unions would be classified as Category 1 credit unions due to the indicative asset size threshold of €100 million for Category 2 credit unions. Therefore, in the main, credit unions will be restricted to a lower yielding universe of authorised asset classes and investments:

- Category 1 credit unions will no longer be able to invest in collective investment schemes, bank bonds and longer term government bonds.
- This may force some credit unions to increase their allocation to cash deposits which are a lower yielding asset class.
- The yield differential between a 5-year senior bank bond with Bank of Ireland and a 5-year cash deposit rate is currently 0.93%[20].
- Category 1 credit unions will not be able to purchase government bonds with more than 5 years term to maturity; this limits them to a lower yielding universe of government bonds.
- The 10-year Irish government bond is yielding 3.26% in contrast to the 5-year government bond which is yielding 1.93%[21].

WARNING: Past performance is no indication of future performance. The value of investments can fall as well as rise.

c) **Counterparty limits:**

- The consultation proposes a counterparty limit of 100% of Regulatory Reserves.
- Based on our analysis, we estimate that this limit, on average, translates to approximately 18% of the investment portfolio. However, some credit unions' Regulatory Reserves represent just 13% of the investment portfolio, while a smaller number's Reserves represent as much as 52% of the investment portfolio.
- This means that certain credit unions may need to introduce or increase exposure to three to four additional counterparties, while others could potentially limit their exposure to just two counterparties. Therefore, the proposed measures do not provide for such extremes which have no real basis in an appropriate investment thesis.
- Whilst the diversification of counterparty risk to a wider range of counterparties is a sensible and prudent investment strategy in theory, based on our sampling, the dilution may be excessive. It is also likely that such counterparties may offer lower yielding cash deposits and therefore this proposal is likely to adversely impact investment income.
- In certain instances, deposit products available are limited to overnight deposits only (Rabobank) while other institutions offer few deposit alternatives beyond 12 months. Furthermore, in an environment where international banks are closing their deposit taking facilities in Ireland, we believe that some credit unions may struggle to source an appropriate number of suitable deposit-taking counterparties.
- Such credit unions may be forced to allocate to government bonds which may introduce unnecessary volatility to the investment portfolio.
- It is noteworthy that senior bank bonds are not included as an authorised investment class for Category 1, and therefore such credit unions will not be able to use senior bonds as a means of diversifying counterparty risk.

ii. More Complex Investment Framework

The proposed framework is more complex in nature and may require additional management:

- Credit unions will be required to manage investments with regard to at least three different reference points. For example, the proposed counterparty limit and asset concentration limits are referenced off regulatory reserves, liquidity is referenced off unattached shares, and maturity limits are laid out as a percentage of the investment portfolio.
- A lower counterparty limit means that additional counterparties may need to be added to the investment portfolio, which may be more onerous in terms of management.

[20] The yield on the BOI 3.25% 2019 Senior Unsecured Bond is 2.92%. The 5-year cash deposit rate is 1.99%. Both rates as at 10th February 2014.

[21] The yields are sourced from Bloomberg as at 10th February 2014.

- Liquidity will be more difficult to manage. The introduction of short-term liquidity constraints means that liquidity will require additional attention and management. We believe that the majority of credit unions would currently meet the proposed limits.
- However, we expect that it may be more difficult to meet the constraints in the future as access accounts become less prevalent and if collective investment schemes are excluded as proposed, attractive liquid investments or term investments with access will be more difficult to source.
- It may be harder to manage excess liquidity in the absence of authorised collective investment schemes which have been the foundation of a number of credit unions' investment portfolios heretofore.
- Finally, the proposed exclusion of bank bonds and longer term government bonds for Category 1 reduces the potential for exposure to liquid marketable securities which play an important function in investment portfolios and contingency funding plans. In the event of an unforeseen liquidity event, they often represent a critical source of additional liquidity.

iii. Cap on Savings of €100,000

We note that there is a proposed cap on savings of €100,000 for both Category 1 and 2 credit unions. In our view, this is penal and potentially obstructive to growth, especially for those core credit unions which are candidates to become the hub of mergers and acquisitions in the years to come. This cap may act as a hindrance to the growth of credit unions' savings, and by consequence, the expansion of loan books and investment portfolios.

iv. Additional Unintended Consequences

The proposed counterparty limit is likely to result in an exodus of cash from the Irish banking system:

- Based on the assumption that credit unions have between 20% and 25% of their investment portfolios with the Irish banks (AIB, BOI and Permanent TSB), the proposed counterparty limit will reduce the majority of credit unions' exposure to approximately 18% of the investment portfolio.
- Based on our estimation that the movement has over €9 billion in investments[22], we believe that up to €2 billion may be withdrawn from the Irish banking system and invested with alternative counterparties.
- The potential for this deposit flight and the adverse impact on the Irish banks should be given careful consideration by the appropriate authorities.

Please note: Until the consultation process concludes, there is no assurance that the proposals will be implemented, and therefore the impact on investment portfolios could be materially different.

[22] The Registrar of Credit Unions (25th January 2014) stated that the total assets of the sector were just below €14 billion and loans to members currently stand at €4.5 billion. Therefore, we believe that €9 billion is a good estimation for the total size of investments. Please see http://www.centralbank.ie/press-area/speeches/Pages/AddressbyRegistrarofCreditUnionsSharonDonneryCUDAAGM.aspx for more information.

Section 4: Summary

At this stage it is clear that the proposed approach is likely to have a serious impact on investments and investment income, and it is regrettably being put forward at a time when income is already under significant pressure due to record low interest rates, the effects of Basel III and more broadly when loan demand is at historically low levels. We are concerned that the proposals, if implemented, may act as further headwind to the sustainability of a number of credit unions and we struggle to understand the rationale for introducing the proposed measures at this time.

This paper looked at just one aspect of a credit union's business (i.e. investments), yet we understand that there are also likely to be far-reaching implications for credit unions' loan books which have not been covered by this paper. Therefore, it is imperative that individual credit unions digest the content of the consultation paper and assess the potential implications for the future of their overall business.

As outlined, Davy is in the midst of ongoing testing and analysis of the consultation paper proposals and we will use the results as the basis for a submission to the Central Bank which will feature constructive recommendations.

Individual Submissions

We understand that it is the intention of a number of stakeholders to make submissions to the Central Bank but, in addition, Davy is urging credit unions to give consideration to making individual submissions to the Central Bank before the closing date of 31st March. These sentiments were echoed by the Registrar for Credit Unions, Ms. Sharon Donnery, who *"strongly encourage(s) you to review the paper and to submit any views or suggestions that you may have. While we are confident that representative bodies will make submissions to the consultation, we also welcome submissions from individual credit unions."*[23] If a large number of credit unions partake in the consultation, it will strengthen the process and is more likely to deliver an outcome that is agreeable for all parties involved.

Conflicts of Interest

As Davy offers a wide range of financial services, it is inevitable that a number of potential or actual conflicts exist. This means that from time to time Davy may have interests which conflict with our clients' interests or with duties that we owe our clients. This includes conflicts arising between the interests of Davy, other entities within the Davy Group and employees on the one hand and the interests of our clients on the other and also conflicts between clients themselves. As well as providing investment management and stockbroking services to credit union clients, Davy may also provide investment services to some companies referred to directly or indirectly in this paper. This includes, but is not limited to, the production and distribution of investment research, the provision of corporate broking services, the provision of corporate finance advice and acting as sponsor. Further information is available on request. Our Conflicts of Interest policy is available at www.davy.ie.

J&E Davy, trading as Davy, is regulated by the Central Bank of Ireland. Davy is a member of the Irish Stock Exchange, the London Stock Exchange and Euronext.

23 http://www.centralbank.ie/press-area/speeches/Pages/AddressbyRegistrarofCreditUnionsSharonDonneryCUDAAGM.aspx

Section 5: Appendices

Appendix 1: Information on the sample of credit unions used by Davy to conduct initial impact analysis

TABLE 3: Davy collated a sample of credit union annual accounts as of 30th September 2013. Information on the sample size:

Number of credit unions: 83		
	Total Sample	**Average Credit Union**
Total Assets	€5.4 billion	€66 million
Total Investments	€3.7 billion	€44 million
Investment income (2013)	€119 million	€1.4 million
Regulatory Reserves	€636 million	€7.7 million
Regulatory Reserves / Total Assets		11.68%
Regulatory Reserves / Investments		18.02%
Regulatory Reserves / Investments - range		13.04% to 51.86%

Appendix 2: Timetable of the consultation process

The Section on Investments of the Credit Union and Co-operation with Overseas Regulators Act 2012 is currently scheduled to be commenced in Q2 2014. Upon commencement, the section of the Credit Union Act 1997 which requires credit unions to manage investments in accordance with the Trustee (Authorised Investments) Order 1998 (as amended in 2002) will be removed and substituted with text which gives the Central Bank regulatory powers with regards to credit union investments. This means that the Central Bank can effectively replace the GN with alternative guidance which will have a legislative basis. It is within this context that the Central Bank intends to introduce a tiered regulatory approach for credit unions.

TABLE 4: Timetable of the Consultation Process

Date	Process
31st March 2014*	Consultation closes - deadline for submissions from credit unions and relevant stakeholders
March 2014 to June 2014	Section 12 (Investments) of the Credit Union and Co-operation with Overseas Regulators Act 2012 is scheduled to be commenced. This will amend the Credit Union Act 1997 to provide the Central Bank with regulation making powers in a number of areas including investments.
May 2014	Central Bank issues feedback and a second consultation paper which includes regulations to implement the tiered regulatory approach.
July 2014	Second consultation closes
October 2014	Central Bank issues feedback and publishes regulations and updated CU Handbook
October 2014 to March 2015	Application period to become Category 2
April 2015	Regulations come into force

**Please note that this has been extended from 28th February 2014. This could have a knock-on impact on the rest of the deadlines.*
Source: Davy with reference to the Central Bank's consultation paper

Appendix 3: The Central Bank's tiered approach to credit unions

	Category 1	Category 2
Description	▶ All credit unions will initially be designated Category 1 credit unions. They will be able to offer a comparable range of services to those that credit unions are currently offering.	▶ Credit unions wishing to undertake a wider range of activities including more sophisticated lending and investment activities will be permitted to apply to the Central Bank to be categorised as Category 2 credit union. ▶ Additional regulatory requirements will apply. ▶ Credit union must have the ability to meet the proposed regulatory requirements including a sound and robust strategic plan, adequate financial and other resources and appropriate governance arrangements. ▶ It is expected that Category 2 credit unions will have assets close to or above €100 million.

Source: Davy with reference to the Central Bank's consultation

Appendix 4: Summary of Proposed Changes to Investment Limits

	Current Guidance	Category 1	Category 2
Authorised Classes Under the GN	**Irish and EMU State Securities** a) Maturity date shall not exceed 10 years b) Not more than 30% of holding shall be held in bonds maturing after 7 years c) Holding shall not exceed 70% of the total value of the credit union's investment portfolio	✓ Maturity date shall not exceed 5 years	✓ Maturity date shall not exceed 10 years
Authorised Classes Under the GN	**Accounts in Authorised Credit Institutions** a) Maturity date shall not exceed 10 years b) Not more than 50% of deposits shall be held in deposits maturing after 5 years c) Not more than 20% of deposits shall be held in deposits maturing after 7 years	✓ Maximum maturity of 5 years	✓ Maximum maturity of 7 years
Authorised Classes Under the GN	**Bank Bonds** a) Maturity date shall not exceed 10 years b) Not more than 30% of bank bonds shall be held in bank bonds maturing after 7 years c) Holding in bank bonds shall not exceed 70% of the credit unions investment portfolio	✗	✓ Senior unsecured Bank Bonds / Corporate Bonds that are listed with a rating of 'A' a) Maximum maturity of 7 years b) Total investments in bank bonds can be up to 50% of a credit union's regulatory reserves. c) Total investments in corporate bonds can be up to 50% of regulatory reserves
Authorised Classes Under the GN	**Investment in Equities**	✗	✗
Authorised Classes Under the GN	**Collective Investment Schemes**	✗	✗
New Class	**Shares and Deposits of other Credit Unions**	✓ Investments in shares & deposits of a single credit union can have a maximum maturity of 5 years and can be up to 12.5% of the Regulatory Reserves	✓
Additional Limits	**Counterparty Limits** a) Investments in a single institution shall not exceed 25% of the total value of the investment portfolio	Investments in a single counterparty other than a credit union can be up to 100% of a credit union's Regulatory Reserves	
Additional Limits	**Maturity Limits** As outlined under individual asset classes above	Up to 50% of the total value of the portfolio can be in investments maturing after 3 years	Up to 50% of the total value of the portfolio can be in investments maturing after 5 years
Additional Limits	**Liquidity** a) 20% of unattached savings (up to 30% if applicable)	20% of unattached savings (up to 30% if applicable) 10% unattached savings available up to 7 days 15% unattached savings available up to 1 month	Liquidity stress tests required

Source: Davy with reference to the Central Bank Consultation Paper

Please note the above information is not exhaustive. It is intended for summary purposes only.

Appendix 5: Background information on the sample credit union used to illustrate the potential impact of the proposals on investments

	€ Amount (million)	% of Portfolio
Regulatory Reserves (30th September 2013)	€12.5	
Total Assets (30th September 2013)	€83.7	
Size of Investment Portfolio (31st January 2014)	€73.5	
Unattached shares (31st January 2014)	€62	
Asset Allocation		
Government Bonds (>5 years)	€3.6	4.89%
Cash Deposits	€51.2	69.59%
Bank Bonds	€4.2	5.77%
Collective Investment Schemes	€3.8	5.2%
Structured Investments (Bank Bonds)	€3.08	4.19%
Structured Investments (Cash Deposits)	€7.6	10.36%
Total	**€73.5**	**100%**
Counterparty Risk		
AIB	€8.5	11.49%
BOI	€16.8	22.85%
PTSB	€17.4	23.76%
KBC Bank	€15.2	20.73%
Ulster Bank	€7.05	9.58%
Rabobank	€1.1	1.5%
Irish Government	€3.6	5.2%
Total	**€73.5**	**100%**
Liquidity	€19.8	31.9% unattached shares

Source: Davy

Appendix 6: Performance Data

	2009 (%)	2010 (%)	2011 (%)	2012 (%)	2013 (%)	10th February 2014 (%)
Irish 5-year Government Bond Yield	3.25	3.14	7.62	3.32	2.18	1.93
Irish 10-year Government Bond Yield	4.84	9.06	8.21	4.52	3.51	3.26
Bank of Ireland Senior Unsecured Bond Yield*	5.01	12.74	15.74	3.41	4.42	2.92

**The yield is based on the Bank of Ireland 4.625% 2013 Senior Unsecured Bond from 2009 to 2013. The yield as at 10th February 2014 is based on the Bank of Ireland 3.25% 2019 Senior Unsecured Bond.*

All data is sourced from Bloomberg as at market close 10th February 2014

WARNING: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up.

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