



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

The Board of Directors

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Dear Directors

PRA Annual Assessment of the Credit Union sector

Your firm is a part of a group made up of credit unions (“CUs”) with total assets above £15 million and/or with more than 10,000 members. This means that in addition to the individual assessment by your named supervisor once every two years, for which you receive feedback, we also carry out an annual assessment of your credit union as part of a larger peer group. This has now been completed and this letter gives our findings.

This letter should be considered by all directors.

Response to Covid-19 pandemic

On 18 March and 8 April we wrote to all CUs, acknowledging the unprecedented operational and financial challenges caused by the pandemic, and outlining our supervisory focus and priorities (<https://www.bankofengland.co.uk/prudential-regulation/letter/2020/letter-to-credit-unions-on-covid-19>). Each CU is different, and the level to which it is impacted will depend on its business model and membership, so it is crucial that the Board regularly monitors the prudential position and key risks, and takes appropriate, timely, action.

We are committed to engaging with CUs on regulatory matters in a proportionate way, which relies on CUs being open and transparent with the PRA and informing Supervision of any significant operational or prudential challenges. If you become aware of any events that are likely to impact on your prudential position or ability to continue to offer your services to members, we expect you to notify the PRA as soon as reasonably possible, by contacting your named supervisor or emailing prudential_creditunions@bankofengland.co.uk.

Single Customer View (SCV) and orderly resolution

Where a CU is likely to have to close, an up-to-date and accurate Single Customer View (SCV) file is crucial for orderly resolution. While we continue testing CUs’ SCV files, prioritising those where we have concerns about sustainability and/ or viability, we expect all CUs, regardless of size, to undertake regular reviews and updates of their SCV data, and carry out testing of SCV files and procedures.

In reviewing SCV policies and procedure, we expect CUs to consider the following:

- A CU is obliged to notify the PRA of any material change to your SCV system (e.g. upon the introduction of a new IT system linked to the SCV system)?
- Can the SCV file be produced in the correct format with all the required fields (see <https://www.fscs.org.uk/globalassets/scv/2017-03-24-fscs-guide-to-scv---mar-2017-final.pdf>)?
- Is more than one individual at the CU able to run/ submit the SCV file?

- Do you compare your SCV file to other management information and databases?
- What process is in place to ensure that members' contact details are up-to-date?

In addition to full SCV testing, CUs now have access to the FSCS self-verification portal, which allows them to test their SCV file at a time that suits them, and receive comprehensive feedback similar to the full testing process. We will generally ask you to use the portal prior to your biennial visit, but please contact your named supervisor if you want to use the portal at any other time (the portal's capacity is limited, so there may be a delay between you submitting your request and using the portal).

Operational risk and resilience

Before undertaking strategic initiatives to expand and develop new activities - especially online - it is essential to carry out a comprehensive operational risk assessment, ensuring appropriate and adequately robust systems and controls.

Outsourcing

Where a CU outsources important operational functions, it remains fully responsible for all its obligations under the regulatory regime. Directors cannot delegate their responsibilities, and the CU must retain the necessary expertise to supervise the outsourced functions.

All CUs using or considering outsourcing should review their arrangements in the light of the requirements listed in Section 14 (Outsourcing) of the Credit Unions Rulebook Part (www.prarulebook.co.uk/rulebook/Content/Part/320139/). This includes demonstrating that the CU is able to terminate the arrangement where necessary without detriment to the continuity and quality of its provision of services to members. We have seen instances where this has not been the case, which poses a risk to CUs and their members.

While reviewing/ considering your outsourcing arrangements, you may wish to consider PRA's Consultation Paper 30/19: Outsourcing and third party risk management (<https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2019/cp3019.pdf>). The consultation concludes on 1 October 2020 and the PRA welcomes any feedback you may have.

Operational resilience

We are seeing an increase in the number of operational and cyber incidents in CUs. Operational resilience means planning, not only around specific and identified risks, but also assuming that any part of the CU's infrastructure could be disrupted. We expect CUs to assume that operational/ cyber incidents will happen, and to have mitigating policies/ procedures in place to ensure their system is resilient, i.e. can absorb shocks rather than contribute to them.

CUs should think about their particular business services, how these could be disrupted, and how they might need to adapt to ensure critical services can continue to be delivered through disruption, with a focus on contingency.

The Board should set their impact tolerance limits - points at which any further disruption would threaten financial stability, safety and soundness or consumer protection. CUs can strengthen their resilience by setting, monitoring and testing impact tolerances for key business services to inform existing and new strategies. While the responsibility lies with the Board, the ownership will generally be shared across the whole CU.

Questions we would expect CUs to consider in reviewing operational resilience include:

- What are the risk thresholds for operational resilience and how are these documented and monitored?
- What are the key assets that the CU is trying to protect?
- Does the CU document the core systems critical to the operation of the business?

- How are external dependencies and risks identified and managed?
- What governance and oversight arrangements for operational resilience are in place?
- How is the Board satisfied that risk governance provides sufficient assurance to the Board on operational resilience effectiveness?
- What recognised standards does the credit union look to achieve?
- What external verification of both operational and cyber resilience is sought?

We expect CUs to notify the PRA as soon as practically possible of any significant operational or cyber incidents or events that may impact on continuity of service as soon as is reasonably possible by contacting the named supervisor or emailing prudential_creditunions@bankofengland.co.uk.

Prudent management

Credit risk

All CU Boards must meet their obligations relating to prudent management and the monitoring and mitigation of risks and must be able to demonstrate that they measure and monitor compliance with key financial ratios, including deterioration in credit quality. Additionally, we expect CUs in this peer group to undertake scenario testing to obtain information and data that allows them to take timely and effective remedial action, such as tightening the criteria for accepting loans applications – preferably on a pre-emptive rather than reactive basis – in order to manage and control the incidences of loan delinquency, impairment and arrears and thereby mitigate and minimise the risk of financial loss arising from provisions for bad and doubtful debts and write-offs.

On 8 April 2020 the PRA invited all CUs to consent to a modification of Rule 3.11. This reduces the minimum provisioning requirement for bad debt in accordance with the direction available from the Waivers and modification page (<https://www.bankofengland.co.uk/prudential-regulation/authorisations/waivers-and-modifications-of-rules>). The letter explaining the modification and how to consent is available on (<https://www.bankofengland.co.uk/prudential-regulation/supervision/credit-unions>). The modified rule only applies to CUs that consent. We encourage all CUs to review the letter and attached FAQs.

Capital requirements

On 13 March 2020 the PRA published Policy Statement 6/20 – Credit Unions: Review of the capital regime which reduced the minimum capital requirement for CUs in this peer group by:

- Moving to a graduated steps approach, with the minimum capital requirement for CUs in this peer group equal to 5% of total assets up to £10m and 8% of any assets above £10m (where applicable); and
- Removing the association between CU additional activities/membership and minimum capital requirement.

While the decreased capital requirement generally offers CUs a greater degree of flexibility and it may remove barriers to growth, the CUs with capital-to-assets ratio below 10% should be aware the PRA rules for distribution of profit (Rule 8.8) and transfers out of the general reserve (Rule 8.9) apply.

Governance

Succession planning

Over the last twelve months many CUs told us that they face increasing difficulties in attracting and retaining new Board members with relevant skills. This has not been made easier by the pandemic and by gradual changes in the volunteer culture. However, CUs must comply not only with PRA requirements, but also with their own rules' requirements for the composition of Board and key committees.

It is important that Boards periodically assess themselves and identify those areas in which they lack the knowledge and expertise pertinent to the governance and oversight of CUs. While the recruitment of volunteers possessing relevant skills may be challenging, it is nevertheless important that the directors make continuous efforts to attract and recruit individuals with appropriate and relevant skills.

Next steps

As directors of a CU, you have personal and joint obligations to serve your members and to meet regulatory and legal requirements. In doing so, we expect you to consider the points set out above and to act appropriately. The content of this letter has been shared with all UK trade bodies and you may wish to discuss with them the points we have made.

If you have questions about the content of this letter, please contact your named supervisor or the PRA's Firm Enquiries Function on 020 3461 7000 / PRA.FirmEnquiries@bankofengland.co.uk.

Yours faithfully



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