

Supervisory Statement | SS2/16

The prudential regulation of credit unions

February 2017

(Updating February 2016)



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



16 March 2020: This SS has been updated. Please see,
<https://www.bankofengland.co.uk/prudential-regulation/publication/2016/the-prudential-regulation-of-credit-unions-ss>

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1 Introduction

1.1 This supervisory statement sets out the Prudential Regulation Authority's (PRA's) expectations of credit unions. It applies to all UK credit unions as defined in the Credit Union Rulebook Part.1

1.2 The statement seeks to advance the PRA's statutory objective of promoting the safety and soundness of the firms it regulates by setting out the PRA's expectations of how credit unions should comply with core elements of the regulatory framework contained in the Credit Union Rulebook Part.

2 Capital

2.1 A credit union will be expected to maintain the relevant minimum requirement specified by the Credit Union Rulebook Part 8.5 at all times.

2.2 A credit union will be expected to notify the PRA immediately should it become aware that it is likely to fall below its relevant minimum capital requirement. It will be expected to comply with the notification requirement in the Credit Union Rulebook Part 8.6 if its capital unexpectedly falls below the relevant minimum.

2.3 Where a credit union subject to a minimum total capital requirement of 10% experiences a stress situation it may, if necessary, employ all or part of the capital buffer element to absorb losses without being in breach of its capital requirement.

2.4 Where a credit union subject to a minimum total capital requirement of 10% uses its capital buffer in the circumstances described in '2.3' above it will be expected to notify the PRA immediately as required by the Credit Union Rulebook Part 8.6. It will also be expected within a reasonable period to provide the PRA with a detailed and evidenced plan to restore its capital buffer. The PRA would normally expect restoration of the capital buffer to be achieved within six months of its use by the credit union.

2.5 Where a credit union with a minimum capital requirement of 5% is experiencing significant growth, whether of member numbers, assets, or both, the PRA will expect to be notified as the credit union moves towards the asset or member number levels at which it will become subject to a 10% minimum total capital requirement.

3 Liquidity

3.1 The PRA expects all credit unions to maintain the minimum prescribed ratio of liquidity at all times and to comply strictly with the notification requirement in the Credit Union Rulebook Part 9.5.

4 Additional activities

4.1 The PRA expects a credit union undertaking 'additional activities' (see Table 1) and subject to the requirement in the Credit Union Rulebook Part 10.3(3) to monitor its relevant business by using the ratios in 4.4, below, calibrated with values that are specifically aligned to its individual business model. The PRA expects the values selected by the credit union to provide

1 On 23 February 2017, this SS was updated – see appendix for full details.

an accurate and reliable business tool by which its Board may routinely and accurately monitor the credit union's performance against its strategic plan and its regulatory obligations. The PRA also expects the credit union to be able to provide details of its chosen ratios and evidence of the rationale underlying them on request.

4.2 The PRA expects such a credit union to review performance against its target ratios at least monthly and to satisfy itself that performance is consistent with maintaining a business that is viable over a 12 month period and sustainable over a 36 month period.

4.3 Where a credit union undertaking additional activities concludes either that its business is no longer viable in the shorter term or sustainable in the longer term, the PRA expects to be notified immediately. The PRA will then expect the credit union to discuss with it what options it may have open to it, such as merger or transfer of engagements, and whether arrangements should be made for an orderly withdrawal from its additional activities.

4.4 By way of example only, the PRA considers that prudent practice suggests that the indicative ratio percentages for all calculations save capital and loans to assets are those outlined in Table 1.

Table 1: Additional activities and ratio

Ratio	Additional investments	Additional lending	Mortgages	Transactional accounts	Indicative ratio
Capital as percentage of total assets	Y	Y	Y		10%*
Credit union's borrowings as percentage of total asset	Y	Y	Y	Y	≤5%
Total shares as percentage of total assets	Y	Y	Y	Y	≥70% and ≤90%
Total bad debt written off as percentage of total loans		Y	Y	Y	≤10%
Net assets as percentage of sum of total shares and juvenile deposits		Y	Y	Y	≥105%
Bad debt (more than three months in arrears) as percentage of total loans	Y	Y	Y	Y	≤20%
Non-earning assets as percentage of total assets	Y	Y	Y	Y	≤10%
Net zero cost funds as percentage of non-earning assets	Y	Y	Y	Y	≥200%
Loan income over 12 months as percentage of total loans		Y	Y	Y	≥6%
Net loans as percentage of total assets			Y	Y	Deliberately left blank

* This ratio is mandatory.

4.5 Table 2 sets out the PRA's definitions of the terms set out in Table 1 for the purposes of the ratio calculations.

Table 2: Definitions for ratio calculations

Term	Definition
Capital	Regulatory capital as defined in the Credit Union Rulebook Part 8, particularly 8.2.
Total assets	The total assets of a credit union that appear on its balance sheet.

Borrowings	The total closing balances of all loans received by a credit union (excluding any subordinated loans), authorised overdrafts and committed lines of credit.
Total shares	The total amount of money held by a credit union, at the relevant date, relating to shares paid in by members, including money held for deferred shares.
Net loans	The total amount outstanding at the relevant date on all loans to members (irrespective of when such loans were made) less provision for bad and doubtful debt.
Net liquid assets	Assets which can be realised for cash at short notice, and within at most eight days, less any liabilities payable within 30 days.
Bad debt	Total amount of loans to members where the loan is more than three months in arrears.
Total loans	The total amount outstanding at the relevant date on all loans to members (irrespective of when such loans were made). This includes any loans written off during the period.
Net assets	Total assets less liabilities (excluding members' shares).
Juvenile deposits	The total amount due to juvenile depositors.
Non-earning assets	The total amount of cash, current account balances (excluding any balances earning interest), prepaid expenses and fixed assets.
Net zero cost funds	The total sum of a credit union's capital and liabilities excluding any liabilities that are subject to interest payable by or charges to the credit union. In practical terms, this is likely to only constitute a credit union's reserves.
Loan income	The total amount of interest received on loans made to members during the 12 month period preceding the relevant date.

5 Maximum deposit levels

5.1 When a credit union gives notice in accordance with the Credit Union Rulebook Part 2.3 it will be expected to inform the PRA of its current loans to assets, capital, and liquidity ratios. It will also be expected to provide the PRA with details of the proposed use of the funds to be deposited and to confirm that its Single Customer View is complete and up-to-date. Should a credit union not satisfy the PRA that its acceptance of such a deposit would be prudent the PRA may be expected to impose a requirement to prevent it from so doing.

6 Fixed-rate shares and deposits

6.1 The PRA expects that any credit union that intends to issue fixed-rate shares or deposits complies strictly with the statutory mandatory requirements that must be satisfied before beginning such activity.¹

6.2 Credit unions that wish to offer shares in an ISA tax-free wrapper will be expected to refer to the relevant regulations issued by HM Revenue and Customs. Credit unions should be aware that approval from HMRC does not provide any degree of exemption from compliance with the statutory requirements referred to above in paragraph '6.1'.

7 Lending

7.1 The PRA expects all credit unions to pay close attention to the quality of their underwriting of loans, whether unsecured or otherwise. Credit unions will be expected to apply a consistent lending policy in making all credit decisions and to retain records of such decisions for at least the life of the loan in question.

7.2 Where a credit union proposes to undertake fixed rate lending (including mortgage lending) the PRA expects the credit union to be able to demonstrate, on request, that it has a thorough understanding of any risks that this activity may create, particularly interest rate risk. In some circumstances the PRA may require any fixed-rate lending for periods of more than two years to be reported using form FSA017.² Where a credit union's fixed-rate lending exposes it to specific material prudential risk it will be expected to make sufficient additional capital provision to mitigate such risk.

8 Investment

8.1 The PRA expects that the assessment required by the Credit Union Rulebook Part 6.5 will be proportionate to the complexity, or otherwise, of the proposed investment.

8.2 The PRA expects the assessment to include consideration of any source and time-band concentrations implicit in the proposed investments.

8.3 The PRA expects all investments made in accordance with the Credit Union Rulebook Part 6.3(1) and 6.4(1) to comply with the 12 month restriction in order to ensure that the investment is entitled to be regarded as a deposit for the purpose of these Rules.

9 Governance and organisation

9.1 Good governance is fundamental to the safety and soundness of all financial institutions. Accordingly, all directors will be expected to fully understand their individual and corporate responsibilities and, in the context of the size and complexity of each individual business, to have the technical competence necessary for them to set, and to oversee, the strategy of their credit union. All directors will be expected to understand the risks implicit in their credit union's business model and to exercise appropriate oversight of the management of those risks.

1 These requirements are accessible via this link:
www.bankofengland.co.uk/pru/Documents/regulatorydata/interestbearingshares.pdf.

2 FSA017 'Interest rate gap report' www.bankofengland.co.uk/pru/Pages/regulatorydata/formscrdfrms.aspx.

9.2 All directors, without exception, will be expected to ensure that their credit union fully complies with the requirements of the Financial Services Compensation Scheme (FSCS) and that their credit union's provisioning policy and practices are prudent and effective.

9.3 In particular, but not exclusively, the PRA expects that:

- (i) directors of all credit unions, irrespective of size and complexity will ensure that the credit union complies with the Fundamental Rules by maintaining its Single Customer View file accurately and in a form agreed by the FSCS at all times;
- (ii) all directors have a thorough understanding of the obligations set out in the Credit Union Rulebook Part 10, 11, 13 and 14, and Part 12 (Whistleblowing) where it applies;
- (iii) directors understand that all outsourcing arrangements are commercial, business decisions, and that sole responsibility for ensuring operational continuity and data security, amongst other things, rests with the individual credit union;
- (iv) where a credit union outsources any of its essential functions, the continuity and quality of the outsourced functions or services must be maintained in the event of termination of the outsourcing either by transferring the outsourced functions or services to another third party or by performing them itself;
- (v) where the credit union outsources its internal audit function it does not employ its external auditor for that purpose unless in exceptional circumstances and, if so, only for the minimum practicable period; and
- (vi) all directors satisfy themselves that their credit union regularly and accurately complies with the provisioning requirements in the Credit Union Rulebook Part 3.11 and 3.12.

Appendix – SS2/16 updates

This appendix details changes made to SS2/16 following its initial publication in July 2016 following Policy Statement 4/16 ‘Reform of the legacy Credit Unions sourcebook’.¹

February 2017

23 February

This statement was updated following publication of Policy Statement 4/17 ‘Responses to CP36/16 and correction to PS2/16 PIN rules’,² to provide a table of definitions of terms used for the purpose of ratio calculations (see new paragraph 4.5 and Table 2).

1 February 2016: www.bankofengland.co.uk/pru/Pages/publications/ps/2016/ps416.aspx

2 February 2017: www.bankofengland.co.uk/pru/Pages/publications/ps/2017/ps417.aspx.