



The Board of Directors

Marcela Hashim
Credit Unions Team
marcela.hashim@bankofengland.co.uk

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Dear Directors

PRA Annual Assessment of the Credit Union sector

Your peer group is made up of credit unions with total assets of less than £15 million, and whose assets have grown by more than 30% and/or whose members have grown by more than 50% in the last financial year. While you are not subject to an individual review, we carry out an annual assessment of your credit union as part of a larger peer group. The 2017 assessment for this peer group has now taken place and we write to you with our findings.

Governance

All credit unions must ensure that their boards meet their obligations relating to prudent management, monitoring and mitigation of risks in line with Section 10 (Governance) of the PRA Rulebook Part for Credit Unions.¹ Credit unions must be able to measure and monitor their compliance with key financial ratios and their underlying financial position and be able to demonstrate this is being done.

Credit unions carrying out any additional activity² must have a financial risk management policy and ensure that the board monitors and assesses the risks associated with the undertaking of such activities on at least a monthly basis. In particular, if considering introduction of new products/services, the board must consider the associated risks of the product, particularly with respect to any capacity to increase the likelihood of a disorderly failure.

We expect the board to be able demonstrate that the credit union has sufficient financial and non-financial resources (including Directors and Supervisors/Internal Audit with relevant skills) to deal with the significant growth over the last 12 months.

The PRA expects the credit unions in this peer group to have a robust risk management process which is underpinned by a Risk Appetite Statement (RAS). The RAS should be tailored to suit each credit union's business model and each board's overall objectives. Done correctly, the risk appetite should feed into the credit union's policies and procedures, thus helping to cascade the expectations set at board level throughout the operations and practices within the credit union.

We expect an RAS to:

- set out the board's (quantified) tolerances of risk in each key business area;
- include indicators (triggers) set at levels agreed by the board where preventative action could still mitigate the emerging risk and prevent the credit union's risk appetite being breached;
- outline the potential preventative actions the board could take once prompted by the triggers; and

¹ See <http://www.prarulebook.co.uk/rulebook/Content/Chapter/320149/05-02-2016>.

² Please see Chapter 4 of Supervisory Statement 2/16 'The prudential regulation of credit unions', February 2017: <http://www.bankofengland.co.uk/pru/Pages/publications/ss/2017/ss216update.aspx>.

- be regularly reviewed (at least annually) to ensure that it reflects the board's risk appetite.

Where directors identify that their credit union is facing financial or other problems, they must notify the PRA as soon as is reasonably possible. Should the credit union have to close, we expect directors to recognise and fulfil their legal and regulatory responsibilities.

Strategic planning

We expect boards of credit unions in this peer group to be able to demonstrate that any significant growth or introduction of new products or services are in line with the board's agreed risk appetite and its longer-term strategy. The board must agree realistic timescales for its strategy, review progress at regular intervals and consider the point at which it would take action to follow an alternative strategy.

The credit unions within this peer group should carry out basic forward-looking stress testing of the business strategy to identify what the prudential impact would be if actual performance differed significantly from some of their targets— possible scenarios to analyse might include share growth greater than expected, lower loan than expected, a rise in base rates, possible changes to the benefit systems, or the potential impact of loss of external funding. This should comprise an analysis of (individual and combined) events including extreme but plausible scenarios.

Single Customer View and orderly resolution

Five small credit unions failed since 1 August 2016 and by using the up-to-date and accurate Single Customer View (SCV) files, the Financial Services Compensation Scheme (FSCS) has been able to make payment to eligible depositors in fewer than seven days in all five cases. During the last twelve months, we have noted an improvement within this peer group with directors assuming the overall responsibility for SCV.

The FSCS' feedback on areas for improvement from testing SCV files included that:

- credit unions tend to depend heavily on a single individual and/or their IT supplier to produce the SCV file and/or to resolve data issues. Frequently there is a lack of training for staff at credit unions on SCV and some credit unions do not have sufficiently detailed procedures and controls for their SCV processes;
- errors in SCV files are frequently caused by manual changes made to the SCV files by credit unions resulting from lack of controls or technical knowledge;
- many credit unions are unable to submit their SCV within 24 hours; and
- transactional accounts can introduce an additional level of complexity in how credit unions produce their SCV files as they may be managed separately from credit unions' core systems.

We expect you to implement regular reviews and updates of SCV data, and testing of SCV files and procedures. When undertaking testing, credit unions should pay particular attention to:

- joint accounts;
- members with multiple credit union accounts; and
- the correct extraction of members' details in line with the minimum address criteria.

You should note that transactional accounts and new services can increase the likelihood of a disorderly failure. They also introduce an additional level of complexity for SCV files as they may be managed separately from credit unions' core systems, increasing the need for frequent updates and testing of the system.

Next steps

As directors of a credit union, you have personal and joint obligations to serve your members and to meet regulatory and legal requirements. In doing so, we expect you to bear in mind the points set out above and act appropriately. This letter has been shared, anonymously, with all UK trade bodies and you may wish to discuss with them the points we have made.

If you have any questions about the contents of this letter, please contact the PRA's Firm Enquiries Function on 020 3461 7000 or email PRA.Firmenquiries@bankofengland.co.uk.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Marcela Hashim'.

Marcela Hashim
Credit Unions Team