BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

FCA
FINANCIAL CONDUCT AUTHORITY

Policy Statement | PRA PS4/16
| FCA PS16/1

Reform of the legacy Credit Unions sourcebook

February 2016

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This policy statement contains feedback to PRA CP22/15 and FCA CP15/21 'Reform of the legacy Credit Unions sourcebook', the final PRA rules which replace the legacy Credit Unions sourcebook 'CREDS', and a PRA supervisory statement and the FCA Board instrument that amends the FCA's Credit Unions sourcebook.

Contents

1 Overview

1.1 This policy statement (PS) provides feedback by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) to responses to PRA Consultation Paper (CP) 22/15 and FCA CP15/21, 'Reform of the legacy Credit Unions sourcebook', published jointly in June 2015.[1]

1.2 The PS also contains the FCA changes to the FCA Credit Unions Sourcebook (CREDS) as a result of the December 2014 consultation by the FCA on forms, transitional and consequential aspects of the new accountability framework for individuals working in banks, building societies, and credit unions (CP14/31).[2]

1.3 This PS is relevant to all UK credit unions. The new FCA rules may also be of interest to consumers that are currently, or may become in the future, members of a credit union, as well as to consumer groups that have an interest in credit unions.

1.4 The appendices to this PS contain:

- PRA final rules and a supervisory statement intended to be read in conjunction with the rules (Appendix 1-3); and
- FCA final rules and guidance in response to both FCA CP15/21 and FCA CP14/31 (Appendix 4).

1.5 In CP22/15 the PRA proposed to delete CREDS in its entirety and to replace it with a new Credit Unions Part in the PRA Rulebook dealing exclusively with matters affecting the financial safety and soundness of credit unions. This PS sets out final rules intended to replace all PRA-designated rules in the legacy sourcebook, 'CREDS' and includes amendments to rules concerning general organisational requirements and whistleblowing.

1.6 In FCA CP15/21 the FCA proposed keeping the parts of CREDS that relate to its statutory responsibilities. It also consulted on removing rules and guidance for credit unions from CREDS that do not specifically relate to the FCA's objectives. The changes to the rules complement PRA changes, by removing unnecessary duplication and potential inconsistency with PRA rules, and making some improvements to CREDS. The FCA provisions will maintain the focus on consumer protection while clarifying the rules that credit unions must follow.

1.7 FCA CP14/31 proposed some forms, transitional and consequential aspects of the new accountability regime, including for individuals working in credit unions. Then in July 2015 the FCA combined its feedback on the responses received to the core forms and on transitional arrangements for the new regime with consultation in CP15/22.[3] In addition, the FCA provided feedback and final rules on the consequential amendments needed to reflect the new regime

1 PRA and FCA Consultation paper 22/15 and 15/21, 'Reform of the legacy Credit Unions Sourcebook', June 2016: www.bankofengland.co.uk/pra/Pages/publications/cp/2015/cp2215.aspx.
2 FCA Consultation Paper 14/31 'Strengthening accountability in banking: forms, consequential and transitional aspects' December 2014: www.fca.org.uk/news/cp14-31-strengthening-accountability-in-banking.
3 FCA Consultation Paper 15/22 'Strengthening accountability in banking: Final rules (including feedback on CP14/31 and CP15/5) and consultation on extending the Certification Regime to wholesale market activities', July 2015: www.fca.org.uk/news/cp15-22-strengthening-accountability-in-banking-final-rules.

in its August publication (PS15/21).[1] However, this did not include the amendments needed to the FCA's CREDS, so the FCA's response now forms part of this PS.

1.8 The PRA is required by the Financial Services and Markets Act 2000 (FSMA) to publish a statement on the impact of rules on mutuals where the final rule differs from the draft of the proposed rules.[2] In the PRA's opinion, the impact on mutuals of the rules as made is not significantly different from the impact of the proposed rules.

1.9 The FCA is similarly required by the Financial Services and Markets Act 2000 (FSMA) to publish a statement on the impact of rules on mutuals where the final rule differs from the draft of the proposed rule. In the FCA's opinion, the impact on mutuals of the rules as made is not significantly different from the impact of the proposed rules.

1.10 The PRA is required by FSMA to have regard to any representations made to the proposals in a consultation, to publish an account, in general terms, of those representations and its response to them, and to publish details of any significant differences in the rules as made. Changes to the proposal include revisions to restrictions on the levels of individual members' shares, to the maximum size of loans and to the capital requirement for certain credit unions. Following consultation the PS now also includes a Supervisory Statement 2/16 'The prudential regulation of credit unions' (Appendix 1) which sets out the PRA's expectations concerning core elements of the new prudential framework.

1.11 The FCA is similarly required by FSMA to have regard to any representations made to the proposals in a consultation, to publish an account, in general terms, of those representations and its response to them, and to publish details of any significant differences in the rules as made. Changes to the FCA proposal include excluding Northern Ireland credit unions from the requirement to submit audited accounts to the FCA, as well as details of how credit unions can inform the FCA of changes to their complaints contacts.

Implementation

1.12 The changes following PRA and FCA CP22/15 and CP15/21 will come into force on 3 February 2016. The changes following CP14/31 will enter into force on 7 March 2016 (in line with the other provisions related to the accountability regime).

2 Responses

2.1 There were 124 responses to PRA CP22/15 and FCA CP15/21 from a range of respondents, including credit unions, trade bodies and professional services firms.

PRA

2.2 The PRA engaged with interested parties at a number of meetings, including a public meeting of the All Party Parliamentary Group on Credit Unions in the House of Commons. Set out below are the PRA's responses to the substantive issues raised in the feedback to CP22/15 where the PRA is making changes to the policy proposals contained in the CP.

Summary of original proposals

2.3 CP22/15 proposed:

1 FCA Policy Statement 15/21, 'Changes to the Approved Persons Regime for Solvency II firms: Final rules (including feedback on CP14/25, CP15/5 and CP15/16), and consequentials relating to CP15/22 on strengthening accountability in banking', August 2015: www.fca.org.uk/news/ps15-21-changes-to-the-approved-persons-regime-for-solvency-ii-firms.

2 Section 138K of FSMA.

(i) Limit on shares and deposits - no credit union will be permitted to allow a member or depositor to be exposed to risk of loss of deposits;

(ii) Framework for additional activities - the historical 'version 1 and version 2' models for credit union activities are replaced with a flexible framework based on a credit union's specific business model which prescribes a range of ratios which are specific to a credit union's business model;

(iii) Minimum capital for a credit union with total assets of £10 million or more, or more than 10,000 members, to be 10%.

(iv) Lending - to be subject to a cap of £500,000;

(v) Liquidity - a credit union must maintain a liquidity ratio of at least 10% at all times;

(vi) Provisioning - requirement to maintain a general provision for bad debts is removed, with specific, tiered, provisioning requirements made mandatory.

(vii) Governance - a credit union's governing body (committee or board) must report to the members at the Annual General Meeting whether the credit union has complied with a number of key regulatory requirements, particularly the Single Customer View requirements for depositor protection;

(viii) General organisational requirements and whistleblowing - a credit union must comply with the general organisational requirements, including the outsourcing rules, and with the whistleblowing requirements, where the latter apply.

Changes to the policy proposals

Limit of shares and deposits

2.4 Respondents were generally unreceptive to the proposed limit on shares and deposits, believing that it would create a public perception that credit unions were unsafe. The PRA has no wish to create such a perception, which would be inaccurate and misleading, and has revised this provision so that it may not reasonably be seen as a blanket restriction on the sector; those very large credit unions that are technically able to issue shares in excess of the Financial Services Compensation Scheme compensation (FSCS) limit will normally be able to do so, subject to compliance with an advance notification requirement to the PRA. This important safeguard will preserve the underlying intention of ensuring orderly resolution in the case of failure.

Framework for additional activities

2.5 There was no common general theme in responses on the proposed framework for additional activities, although there was recognition that the historical 'Version 1 / Version 2' classification should be replaced. There was also considerable support for a framework based on quantitative ratios but an equal degree of concern that the framework would impose a rigid structure of prescribed regulatory requirements on the diversity of existing credit union models. Concerns were expressed that certain of the proposed ratios would prove impossible to meet in certain economic environments. Some respondents believed that the proposed 10% minimum capital requirement would introduce additional cost since they would always wish voluntarily to hold a buffer above the minimum. Taking these responses into account, the PRA has modified the proposals so that:

- The 10% capital requirement will be composed of two elements, an 8% minimum to be maintained at all times and a 2% capital buffer which will be available to a credit union to absorb losses in stress situations;
- All relevant ratios must be calculated by a credit union by reference to its specific business model and the environment in which it operates;
- The PRA will provide indicative ratios based on its experience of the sector as a whole but a credit union board must decide the ratios that correctly reflect its business model and monitor performance against them.

Larger credit unions

2.6 A number of respondents expressed concern that the proposed capital requirement for larger credit unions would unreasonably and unnecessarily constrain the growth of member numbers. The PRA accepts that, owing to their membership profiles, some credit unions might find it challenging to comply with the proposed capital minimum ratio as their membership numbers grew and in view of reasoned arguments advanced by a number of respondents, the PRA has decided to adjust its supervisory approach so that it can mitigate those risks. Accordingly, the member-number threshold applying to this requirement has been revised to 15,000 which, coupled with changes made to the composition of the 10% capital requirement, will permit credit unions to grow organically and to build their capital reserves over time.

Lending

2.7 Some respondents argued that no restrictions should be placed on lending. The PRA considers that removing all limitations in all circumstances would not be appropriate and does accept that a fixed cap of £500,000, as originally proposed, could constrain prudent lending by some larger credit unions. This has been removed, but maximum advances will remain subject to a ceiling directly related to a credit union's total non-deferred shares.

Provisioning

2.8 The proposed removal of the general provision received mixed responses, some supporting it. The PRA considers that the use of a general provision no longer reflects generally accepted best practice and may in fact encourage unsatisfactory provisioning practice in credit unions. Respondents objected to the proposed requirement that bad debt more than 12 months in arrears should be written off and the PRA accepts that this provision might create an incorrect perception that such debts have been extinguished. It has, therefore, has been removed, leaving credit unions holding such debt to make specific provision for 100% of the net liability in their regulatory accounts.

2.9 The provisions of CREDS 4, among other things, allowed version two credit unions to pay dividends out of interim profits more than once a year while explicitly prohibiting version one credit unions from doing so. Our consultation proposed that no credit unions would, in future, be able to pay dividends out of interim profits more than once a year. However, responses received on this proposal demonstrated that it should not be proceeded with and the rules will continue to permit credit unions that meet specified requirements to make such payments.

Definitions

2.10 Respondents raised a number of possibly adverse consequences that would flow from some of the definitions in the proposed rules. In particular, respondents asked for more clarity and certainty concerning the types of business that would constitute Payment Services and pointed out that the proposed definition of mortgage contract would preclude a credit union from making advances secured on second charges on property. The PRA has refined certain definitions in the rules, particularly those for payments services and to make it clear that second charges may still be accepted as security.

2.11 In order to take into account developments in the structure of the PRA Rulebook, a small number of consequential deletions proposed in CP22/15 have not been pursued.

General feedback to responses to the PRA

2.12 Outsourcing – some respondents raised concerns about the incorporation in the proposed rules of material that was included as Guidance in CREDS. The PRA considers that it is appropriate that this material should be an explicit requirement, it being a long-standing regulatory principle that performance of outsourced functions at all times remains the responsibility of a regulated firm.

2.13 Capital - a number of respondents asked us to apply a risk-based capital regime based on the Basel model. The PRA does not consider that it would be either appropriate or feasible to create such a regime for the entire UK credit union sector, taking account of its diversity and of the fact that it remains predominantly volunteer-run and governed. The PRA considers that any benefits of such a regime would be confined to a few, very large, credit unions with the resources required to implement and to operate a risk-based regime, while imposing a possibly insuperable burden on a material part of the sector. However, the PRA will keep this question under review and intends to enter into discussions with interested parties to explore the potential for introducing a differentiated capital regime in the future. Some respondents suggested that a substantially higher minimum capital ratio for all credit unions should be introduced, suggesting that 5% or 6% should be the minimum. The PRA does not consider a 3% capital ratio as being anything more than the absolute minimum that all relevant credit unions should aspire to exceed. Equally the PRA considers that raising the lowest capital hurdle at present would both constrain, and in some instances harm, very small but successful credit unions and create a significant barrier to entry for some new credit unions. Finally, one respondent proposed that all credit unions writing mortgages should be required to adhere to the more rigorous capital regime applied to all other mortgage writers. At present, the PRA does not consider that it is necessary to devise a specific capital regime for mortgage-writing credit unions and this question will be kept under review, dependent on the development of mortgage business in the sector.

2.14 A number of respondents were concerned that the proposals would have economic and competition implications, although most responses were largely non-specific. One of the main issues where detailed arguments were made concerned the potential economic impact on credit unions that wished at all times to maintain a buffer over-and-above the regulatory minimum. It was argued that the effect on some credit unions of maintaining an additional 2% capital would impose a punitive economic cost when, they felt, prudent management obliged them to maintain a buffer in all circumstances, although this was not a regulatory requirement. Similarly, the impact of linking a member-number threshold of 10,000 to a proposed 10% capital ratio requirement was thought to be an unreasonable constraint on growth. The PRA has made changes to its proposals to take account of these responses, as described in paragraphs 2.5 and 2.6. Some respondents raised concerns that the routine calculation of ratios would create a significant cost. The PRA considers that the calculation of even the full suite of ratios is very straightforward; the data required to perform the calculations is already routinely reported to the PRA and no credit union can reasonably expect to conduct its relevant business safely without having such data readily available at all times. Finally, a number of respondents asserted that the consultation, which was for an extended period of more than three months, had been deliberately timed to coincide with regional school holidays to preclude full responses. The PRA considers that the timing and length of consultation were in-line with statutory requirements.

FCA feedback regarding changes to the legacy Credit Unions Sourcebook

2.15 This section covers FCA changes to CREDS as a result of CP15/21.

Feedback to the questions asked by the FCA in CP15/21

2.16 In the paragraphs below the FCA responds to the six FCA-specific questions it asked in the CP15/21. Most respondents had little if anything to say in answer to the specific questions the FCA asked.

FCA Question 1: Do you agree with the FCA's proposed changes to revoke rules and guidance in CREDS which do not relate specifically to its objectives, or may be inconsistent with PRA rules?

2.17 Most respondents, of those that specifically answered this question, agreed that this was a sensible approach. The responses included the comment that these changes would provide greater clarity to credit unions. Some asked if all the rules relating to credit unions could be put into a single document. There was some concern about changing the existing guidance into rules. On the other hand, there was also concern about the FCA keeping as guidance (to avoid conflicts with SYSC) some provisions that the PRA is making into rules. There was also a request for the FCA to provide a consolidated version of the new rules so that they would all be available in one document.

2.18 **FCA response:** The FCA will proceed with revoking rules and guidance in CREDS which do not specifically relate to its objectives, or may be inconsistent with PRA rules. A consolidated version of the FCA provisions will be available in the online FCA Handbook; the FCA is not providing a joint handbook with the PRA given that the intention of the consultation was to divide the FCA and PRA provisions into a separate FCA CREDS sourcebook and a PRA Credit Union Rulebook Part.

FCA Question 2: Do you agree with the FCA's proposed rule addressing disclosure on subordinated debt?

2.19 Most respondents who commented on this question agreed with this proposal. Some voiced potential concerns; however these concerns appeared to be based on a misunderstanding of the proposals, e.g. appearing not to realise that subordinated debt is already excluded from compensation scheme coverage; that there has been a PRA rule requiring the disclosure of its lack of compensation scheme coverage; that this would not require the disclosure of sensitive information; or that it applies to credit unions in Northern Ireland.

2.20 **FCA response:** The FCA has decided not to introduce this rule at this time. The FCA is considering an alternative approach to address this and may consult on a replacement at a later date.

FCA Question 3: Do you agree with the FCA's proposed changes in CREDS 2?

2.21 Most respondents who commented on this question agreed with this proposal. There was general agreement with the proposal to revoke rules and guidance in CREDS that do not relate to the FCA’s objectives, or could be inconsistent with PRA rules. Where the FCA proposed to convert some guidance into rules to bring FCA provisions into line with new PRA rules, questions included the need for this, and how the FCA will supervise and monitor these requirements. There was also a question about possible conflicts with the PRA requirements (particularly relevant where the PRA is making rules but the FCA is not changing guidance into rules due to the existing FCA provisions in SYSC). Some requested changes to SYSC, for instance to provide an integrated place for credit unions to find both SYSC and CREDS requirements, as well as clarity on timelines for potential future changes.

2.22 **FCA response:** There were no comments that the FCA considered required a change in its approach. The FCA is not dis-applying the Senior Management Arrangements, Systems and Controls sourcebook (SYSC) for credit unions at this stage. However as proposed in CP15/21, the FCA is joining the PRA in making rules from some provisions currently contained as guidance in CREDS 2 (where this is consistent with current SYSC provisions).

FCA Question 4: Do you agree with the FCA's proposals on receipt and publication of credit unions' audited accounts?

2.23 Most respondents who commented on this question agreed with this proposal. However, credit unions and trade associations from Northern Ireland questioned the need for them to send the FCA audited accounts as these are already published on the DETI's website. Some respondents from Great Britain similarly saw no need to change the current approach. The FCA also received suggestions that certified annual returns rather than statutory accounts should be published, as these would be more standardised than accounts. However, none of the responses provided clear evidence of any significant burden that would be caused as a result of the proposed requirement.

2.24 **FCA response:** Following the useful feedback from the consultation, the FCA has decided to exclude Northern Ireland credit unions from the requirement to submit audited accounts to the FCA given that they are already submitted to DETI, which makes them publicly available. Other than that, the FCA is introducing the requirements as planned except for minor technical amendments.

FCA Question 5: Do you agree with the FCA's proposed changes to the requirements for submitting the quarterly and annual return?

2.25 Overall, respondents agreed with the FCA's proposal to remove the requirement (from FCA rules) for credit unions to submit quarterly or annual returns to the PRA, although there was a request for clarity on the FCA requirement to send these to the PRA given the existing reference in SUP. Other comments included the possibility that there may be confusion between the FCA's request for audited accounts but not an annual return.

2.26 **FCA response:** While the FCA notes that the PRA is retaining its requirement for credit unions to submit quarterly and annual returns to the PRA, the FCA is going ahead with the proposal to remove this requirement from CREDS. This is the first step in removing this requirement from the FCA's Handbook; the FCA may consult at a later point on removing remaining requirements from its Handbook for credit unions to submit these returns to the PRA. The FCA will, via its Memorandum of Understanding with the PRA, still be able to access data from these returns when necessary.

2.27 The FCA is also providing clarity that credit unions should continue to submit changes to their complaints contacts to the FCA, and that this should be done by email, post or hand delivery to the Static Data team at the FCA.

FCA Question 6: Do you have any comments on the corrections and updates included in the draft Board instrument?

2.28 A minority of respondents provided specific responses to this question. Some general comments included that these changes seemed to be consistent and useful. The FCA also received the recommendation that it would have been better for the FCA to wait to consult until after the PRA had published its new rulebook.

2.29 There was a specific suggestion that the final bullet point under CREDS 2.2.34AR was overly prescriptive; this point requires that credit unions compare their actual performance with planned and previous performance.

2.30 **FCA response:** The FCA is introducing these changes as proposed except for minor technical amendments. With regard to comments regarding the timing of FCA changes being made at the same time as those of the PRA, the FCA notes that it is doing so intentionally to minimise the possibility of conflicts or inconsistencies between PRA and FCA requirements, and to ensure that credit unions can implement all changes together, rather than implement two sets of changes in quick succession. In respect of the comment about CREDS 2.2.34AR being overly prescriptive, the FCA believes that this fifth bullet clarifies to credit unions what it expects from them, and notes that it is based on an existing guidance provision (CREDS 2.2.34G) which the PRA is also making into a rule.

Other comments relevant to the FCA in response to CP15/21

2.31 The FCA also received some comments that did not clearly relate to its consultation questions. Some of the key points raised in these are summarised below, particularly where they relate to CP15/21.

2.32 Many of the general comments related to the timing of the consultation over the summer. In the FCA's view, particularly given the limited nature of the FCA changes, the time allowed for the consultation (just over three months) was sufficient despite its having fallen over the summer months.

2.33 There were also some comments regarding the cost benefit analysis provided in the consultation paper. As the FCA explained in CP15/21, it did not expect its proposals to impose significant costs on credit unions. Reviewing the feedback, on balance, the FCA believes that its original assessment was correct.

2.34 One respondent also commented that the PRA and FCA had not given sufficient consideration to the impact of the proposals on women. The FCA notes that the response provided no concrete evidence or data to support concerns that the changes would have a disproportionate impact on women. The FCA also notes that the extent to which women would be disproportionately impacted by any changes to credit union regulation could well be dependent on the common bond of the particular credit union (some of which may tend to include more women, while others may tend to include more men).

2.35 **FCA response:** Having considered them, the FCA is not planning any significant changes as a result of general comments received.

What do credit unions need to do next?

2.36 The changes in the rules that form part of this Policy Statement as a result of CP15/21 will come into effect on 3 February 2016 (at the same time as the PRA's changes based on that Consultation Paper). Those made as a result of the accountability regime will come into effect on 7 March 2016 (at the same time as the wider changes being made by the accountability regime).

2.37 Credit unions will need to consider what changes they may need to make as a result of these changes, particularly noting the requirement for credit unions in Great Britain to submit audited accounts to the FCA (as well as the PRA), the increased expectations on all United

Kingdom credit unions' governing bodies to review relevant policies and procedures, and the need to update compliance and policies and procedures manuals as appropriate. Credit unions should also note that they must inform the FCA of any changes to their complaints contact by email, post or hand delivery to the FCA's Static Data team.

FCA feedback regarding amendments to CREDS as a consequence of the new accountability regime

2.38 This section covers changes to CREDS arising from CP14/31 on forms, transitional and consequential aspects of the new accountability framework for individuals working in banks, building societies, and credit unions.[1]

Feedback provided regarding the new accountability regime

2.39 The FCA provided feedback on the responses to the core forms and on transitional arrangements for the new regime in its July publication (CP15/22).[2] In addition, the FCA provided feedback and final rules on the amendments needed to reflect the new regime in its August publication (PS15/21).[3] However, this did not include the consequential amendments to CREDS, which the FCA is responding to as part of this policy statement.

Responses received with regard to CREDS

2.40 There were no significant comments received in response to the FCA elements of the December 2014 consultation (CP14/31) on the proposed consequential amendments to CREDS.

2.41 **FCA response:** As a result, the FCA has proceeded to make those changes with minor amendments where necessary to reflect changes in the core policy (as set out in CP15/22), and to reflect the changes set out in this PS which are being made following CP15/21.

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1 FCA Consultation Paper 14/31 'Strengthening accountability in banking: forms, consequential and transitional aspects' December 2014: www.fca.org.uk/news/cp14-31-strengthening-accountability-in-banking.

2 FCA Consultation Paper 15/22 'Strengthening accountability in banking: Final rules (including feedback on CP14/31 and CP15/5) and consultation on extending the Certification Regime to wholesale market activities', July 2015: www.fca.org.uk/news/cp15-22-strengthening-accountability-in-banking-final-rules.

3 FCA Policy Statement 15/21 'Changes to the Approved Persons Regime for Solvency II firms: Final rules (including feedback on CP14/25, CP15/5 and CP15/16), and consequentials relating to CP15/22 on strengthening accountability in banking', August 2015: www.fca.org.uk/news/ps15-21-changes-to-the-approved-persons-regime-for-solvency-ii-firms.

Appendices

1	**Supervisory Statement 2/16 'The prudential regulation of credit unions' available at www.bankofengland.co.uk/pra/Pages/publications/ss/2016/ss216.aspx**
2	**PRA Credit Union Rulebook Part available at www.bankofengland.co.uk/pra/Pages/publications/ps/2016/ps416.aspx**
3	**Handbook (Credit Unions) Consequentials Instrument 2016 available at www.bankofengland.co.uk/pra/Pages/publications/ps/2016/ps416.aspx**
4	**FCA Board Instrument, available at: www.handbook.fca.org.uk/instrument/2016/FCA_2016_5.pdf**