



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 credit union is a member of the peer group made up of credit unions with total assets above £15 million but below £40 million. This means that in addition to the two-yearly individual assessment by your named supervisor, for which you receive individual feedback, we also 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.<sup>1</sup> 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.

#### Internal audit / Supervisory Committee

Over the last 12 months, we have noted a positive trend in strengthening the level of challenge in credit unions through either the recruitment of additional supervisors and/or seeking support from external third party firms. Where an external function and a Supervisory Committee co-exist, we expect there to be clear terms of reference and effective communication in place to ensure that each is aware of the other's scope of responsibilities and the work being undertaken so that there is no risk of duties either overlapping or work 'falling through the cracks'. Credit unions should put in place a risk-based, forward-looking audit work programme designed to provide a robust and effective challenge to senior management and the board on matters pertaining to the credit union's strategy, operations, governance and oversight.

#### Succession planning

While boards are generally aware of the need for succession planning and taking steps to bring new individuals onto the board, many credit unions do not have a formal, written succession plan in place. In the event of an unforeseen or abrupt departure or absence of key individuals (either a member of staff or a director), this could impact the operational effectiveness of the credit union and its ability to deliver on its objectives. We actively encourage credit unions in this peer group to have a formal, written succession plan that has been approved by the board. The succession plan should have a specific focus to the board and senior management team, including defining the roles, responsibilities and duties of senior members of staff.

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

## Risk management

We have noted a number of credit unions in this peer group introducing dedicated Risk Committees and extensive Risk Registers. 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
- be regularly reviewed (at least annually) to ensure that it reflects the board's risk appetite.

## Policies and procedures

During our visits to credit unions within this peer group we noted that a significant number of credit unions had policies that were general and did not contain sufficient level of detail. We expect credit unions to review their policies and procedures to ensure that they are fit for purpose at any given time and that they allow the board and senior management to manage the credit union effectively. While reviewing the policies, we would generally expect boards to prioritise their particular risks, and their internal audit and investment policies to ensure that they are relevant and proportionate to each credit union's particular business model and that they clearly, fairly and accurately the board's collective appetite for and tolerance of risk.

## **Strategic planning**

While the credit unions in this peer group generally have a strong capital position, the trend of growth in savings and surplus funds exceeding increases in lending continues, raising concerns about longer-term sustainability. We are aware of a number of credit unions taking action to stop or reverse these trends. We expect boards to consider changing economic circumstances, agree realistic timescales for their 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 proportionate and forward-looking stress testing of the business strategy to identify what the prudential impact would be if the targets set are not met – possible scenarios to analyse might include share growth greater than expected, lower loan/investment income than expected, a rise in base rates, possible changes to the benefits system, closure of a local employer or the potential impact of the UK's decision to leave the European Union. This should comprise a basic 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.

Should you be in financial difficulty we expect you to notify the PRA (and your named supervisor) as soon as is reasonably possible.

### **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](mailto:PRA.Firmenquiries@bankofengland.co.uk).

Yours faithfully



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