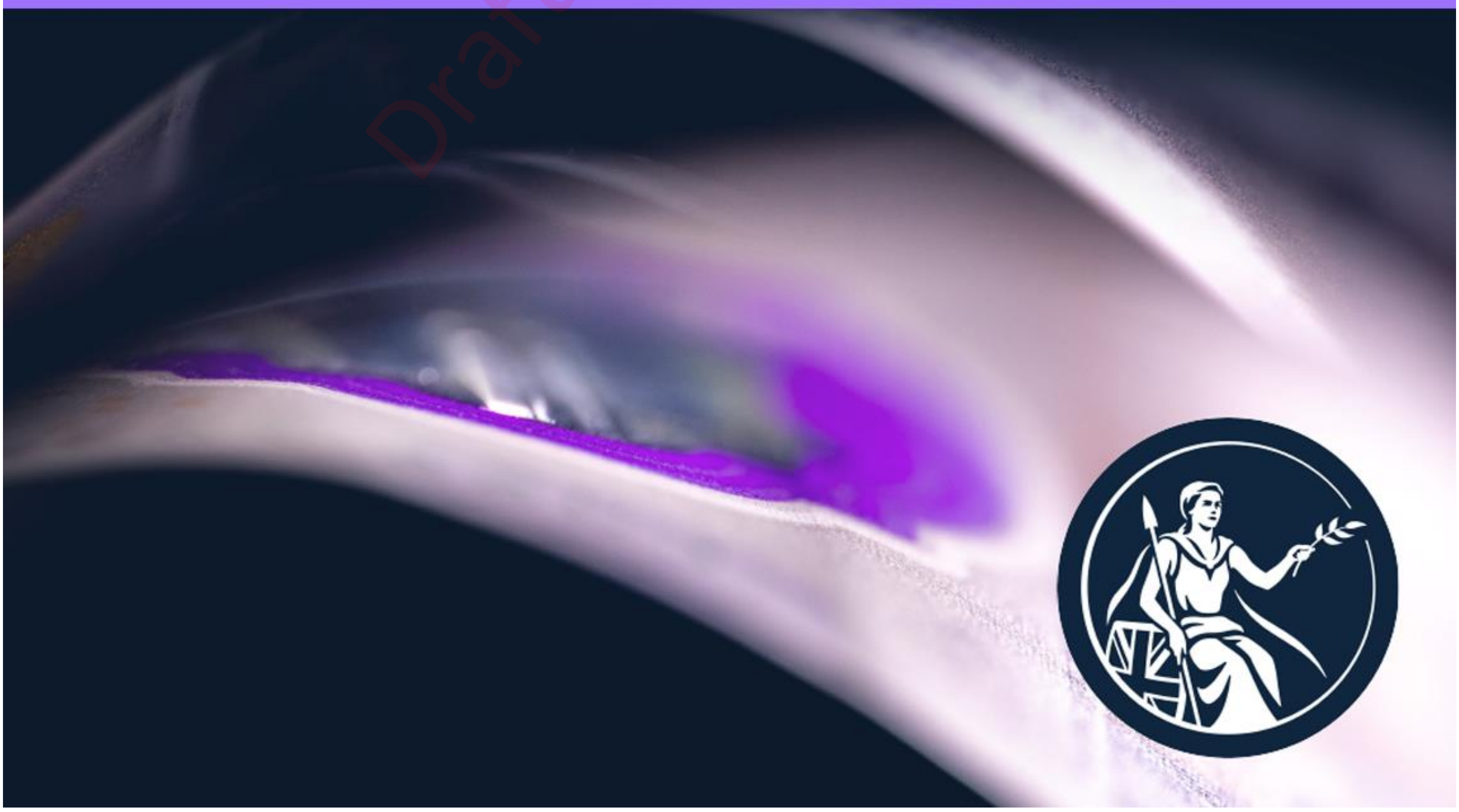
Bank of England PRA

Appendix 2 to CP13/25 – Credit Union Service Organisation

Consultation paper | CP13/25

June 2025



17. Additional expectations for credit unions that provide mortgages

17.1 Credit unions that provide mortgages are expected to consider the additional risks to which they are exposed, and put in place appropriate systems and controls to monitor and mitigate those risks. ~~As part of this, the PRA considers it good practice for these credit unions to consider the key risks inherent in mortgage lending as highlighted in SS20/15 Supervising building societies' treasury and lending activities.~~[16] ~~The PRA acknowledges; however, that the expectations set out in SS20/15 may not all be applicable to such credit unions and the size, scale, and nature of a credit union's mortgage book should be taken into account to ensure a proportionate approach. For example, the ability to gain Mortgage Indemnity Guarantee (MIG) insurance may not be feasible due to low volumes.~~

17.2 In particular, it is good practice for credit unions that provide mortgages to: ~~have regard to Chapter 3 of SS20/15 (lending) and ensure they consider relevant sections. It is good practice for such credit unions to:~~

• be able to evidence that they have given consideration to the relevant risks and put mitigating controls in place where they consider it appropriate. Risks to be considered include:

- affordability risk profile including appropriate controls over interest only mortgages, to ensure that repayment of the loan principal at maturity is achievable;
- accurate and verifiable assessment and valuation of security;
- pricing of risk. Credit unions are expected to have risk pricing models that at a minimum take into account ~~the~~ factors including information from the credit reference bureaux, the outcome of their internal stress testing, the underlying cost of funding the loan and the credit union Board's target return on capital, ~~outlined in Chapter 3 of SS20/15~~; and
- the risks inherent in different sub categories of mortgage lending (eg impaired credit, buy-to-let lending, self-build lending, shared ownership, lending in and into retirement, and commercial real estate lending).

• review their board-approved lending policy to ensure it is consistent with the risk appetite agreed by the board. ~~its aims and contents align with Chapter 3 of SS20/15.~~

• put in place risk management controls that are appropriate and proportionate to the types of business undertaken~~, as set out in SS20/15~~.

[16] ~~April 2015: https://www.bankofengland.co.uk/prudential-regulation/publication/2015-supervising-building-societies-treasury-and-lending-activities-ss.~~

• have in place lending limits set by reference to available management expertise and risk management capability~~ as set out in SS20/15. The PRA expects the lending limits outlined in the credit union's lending policy to resemble the Traditional Approach set out in Appendix 2 of SS20/15 (credit unions should; however, use 'total mortgage book' instead of 'total loan book' when calculating the indicative limits). In some instances, credit unions may set different limits dependent on their risk appetite; in such instances the credit union should make the PRA aware of the limits, the rationale, and any risk mitigation arrangements.~~

17.3 In line with the requirements in Rule 10.3 of the Credit Unions Part of the PRA Rulebook, credit unions providing mortgages should also ~~consider Chapter 4 (Financial risk management) of SS20/15 and~~ be able to evidence that they have given consideration to ~~the~~ key financial risks~~ described~~, and how they are managing and mitigating these. The key financial risks include:

• liquidity risks, arising from maturity transformation;

• funding risk, arising from the relative stability of different funding sources and reliance on new funding to replace outflows;

• wholesale counterparty credit risk interest rate risks: a credit union that provides mortgages should have an adequate system for managing financial risks arising from fluctuations in interest rates. The PRA expects credit unions that have a fixed-rate mortgage book to be able to demonstrate that they are managing the interest rate risks adequately. ~~Such credit unions should follow, to the extent possible, the risk analysis elements of the financial risk management indicative control framework in Appendix 3 of SS20/15 for the administered approach.~~ The PRA expects such credit unions to discuss their approach for managing interest rate risk with their supervisor and share their plan; and

• operational risks in treasury and related activities.

17.4 Credit unions that provide mortgages are expected to have in place internal controls on treasury financial risk management (see Rule 10.3 of the Credit Unions Part of the PRA Rulebook). As such, these credit unions should ~~review relevant sections of paragraphs 4.6-4.31 of SS20/15 and~~ consider, as evidence of good practice:

• establishing a board-approved treasury management policy that governs all areas of treasury activities. ~~(see paragraph 4.6 of SS20/15);~~

• the imposition of policy limits, set as part of the overall board policy~~ (see paragraphs 4.9-4.13 of SS20/15)~~; These are expected to confirm risk positions within levels considered by the board and management to be prudent, given the size, complexity and capital needs of the credit union.

• putting in place risk management systems and controls that are proportionate, and appropriate for the business they intend to undertake. This includes stress testing to evaluate the impact on income of abnormal market conditions, and board information reporting; ~~(see paragraphs 4.15-4.27 of SS20/15);~~ and

• conducting an independent review of treasury activities, including adequacy of controls over maturity mismatch ~~(see paragraphs 4.28-4.31 of SS20/15)~~.

Liquidity

17.5 Credit unions that provide mortgages are expected to meet the liquidity stress testing expectations set out in paragraphs 12.1 to 12.4.

Commercial real estate (CRE) lending

17.6 Credit unions engaged in, or wishing to engage in, commercial real estate lending should be mindful of the different nature of the risks associated with this activity. For example, commercial property will generally require different valuation skills to residential housing and has a significantly higher default rate. As such, the PRA expects credit unions undertaking or considering undertaking this activity to carefully consider the associated risks ~~paragraphs 3.48- 3.53 of SS20/15~~ and be able to evidence that they have adequate risk controls in place.

18. Credit unions that use or own Credit Union Service Organisations (CUSOs)

18.1 Under Rule 6.3(6) of the Credit Unions Part, credit unions are permitted to invest in CUSOs. CUSOs are entities that are owned by credit unions and provide shared ancillary services exclusively to credit unions and their members, for the benefit of those credit unions and their members, providing economies of scale benefits.[17] Credit unions that invest in or, (where relevant) use CUSOs, are expected to meet the expectations set out in this chapter.

18.2 In meeting the expectations set out in this chapter, credit unions will need to keep in mind the legislative prohibition on subsidiaries (this prevents a credit union owning a majority ownership of a subsidiary or a controlling interest in a subsidiary) set out in the Credit Unions Act 1979. There is no such restriction on Northern Irish Credit Unions.

18.3 Properly governed and operated, CUSOs can have an important role in facilitating credit union growth and ensuring their sustainability. However, there are a number of risks inherent to CUSOs which need to be properly managed including reliance on third parties without adequate governance and controls, movement of activity to non-supervised entities, the creation of single points of failure and step-in risk.

Investing in a CUSO

18.4 The PRA expects credit unions wishing to invest in a CUSO to engage the PRA at an early stage in the process.

18.5 Before investing in a CUSO the PRA expects a credit union to carry out appropriate due diligence (and be able to evidence that they have carried this out). In particular, in advance of investing in a CUSO, the credit union should provide to the PRA:

- a description of the intended governance, management and staffing, and services that the CUSO will provide (noting that CUSOs must only provide products and services that are in the interests of credit union members and related to the services provided by a credit union);
- a description of how the CUSO will be funded, including initial investment and ongoing investment commitments; and
- a description of how the credit union has satisfied itself that the credit union's liability is limited to the amount invested (as per paragraph 18.7 below).

17 The types of services that a CUSO may offer may include administrative, professional, trade body, management, technology, collection, human resources services and any other similar services. Although by this definition, credit union trade associations may be considered to be CUSOs, the PRA does not consider the expectations in this chapter to apply to trade associations given the different nature of their activities and services. The services provided by a CUSO are not regulated activities.

18.6 The PRA may also seek assurance (and may ask for evidence) that the credit union has, before investing in a CUSO, or, establishing a CUSO:

- oversight of the CUSO's business plan;
- undertaken a risk assessment (including business continuity risk assessment, assessment of financial risk, operational risk, business model risk, governance and management risk, outsourcing risk and substitutability risk); and
- a clear view of the proposed exit strategy and termination processes

Limiting the liability of the investing credit union

18.7 The PRA expects credit unions investing in a CUSO to ensure that the liability of an investing credit union is limited to the amount that they have invested (ie to ensure that a credit union is not using its funds to prop up a failing CUSO). Accordingly, the PRA expects:

- where a credit union uses its own capital to fund the investment, the amount a credit union invests in one or more CUSO(s) should be no more than 5% of its total capital. In certain circumstances investments may exceed this limit (for example one off set-up costs), however, in such cases the PRA would expect the credit union to engage with the PRA on their rationale and plan to mitigate any associated risks. We note that CUSOs would still be able to charge ongoing fees to users for the services provided.
- a credit union that intends to invest/ has invested in a CUSO to be able to evidence how they have satisfied themselves that the credit union is legally and operationally separate from the CUSO and that the credit union's liability is limited to the amount invested.
    - A credit union may wish to obtain written legal advice as to whether the CUSO arrangement meets this expectation.
    - The CUSO board should include at least one independent director.
- that the credit union investing in a CUSO shares the CUSOs accounts with the PRA on request. The PRA expects credit unions to take reasonable steps to ensure that written agreements with CUSOs provide the credit union and the PRA, and any person appointed by the credit union or the PRA, with access to and unrestricted rights for financial information.

Credit Unions already invested in, or using, a CUSO

18.8 Credit unions that have already established a CUSO should review paragraphs 18.4-18.7 above and consider whether they are able to meet these expectations. Credit unions should be expected to be able to provide this information to the PRA on request. Where their CUSO arrangement does not meet the above expectations they should inform the PRA and set out a mitigation plan.

18.9 Credit union investments in a CUSO should not exceed the limit set out in paragraph 18.7 above. Where a credit union's investment exceeds this limit they should engage with the PRA on their plan to meet this expectation.

18.10 Credit unions are expected to inform the PRA which CUSOs they have invested funds in and in advance of entering into a material outsourcing agreement with a CUSO (as per paragraphs 10.4 and 10.5 of Chapter 10). This is to ensure that the PRA can understand the impact on a disruption/ failure scenario and act quickly.

Outsourcing expectations – expectations for credit union owners and users

18.11 There are a number of existing rules and expectations on outsourcing, governance, risk management and business continuity that apply to credit unions when outsourcing services to a CUSO.[2] The fact that the credit union may (part) own the CUSO in no way diminishes the credit union's board and management accountability and responsibility to ensure outsourcing risks are identified, assessed, monitored, reported on and managed.

18.12 In addition, credit unions that part own CUSOs are expected to have a policy setting out how they will supervise the CUSO activities and manage any associated risks. This should cover:

- responsibilities of the board;
- management and board reporting;
- details of the line of risk oversight of outsourced activities including incident reporting;
- procedures for identifying, managing and mitigating risks including conflicts of interest;
- business continuity and substitutability arrangements; and
- the process for exiting the CUSO arrangement.

Proportionality

18.13 Where a credit union has outsourced its services to a CUSO but does not own the CUSO, credit unions are reminded that the PRA's outsourcing expectations apply proportionately accordingly to the size and activities of the credit union – eg the PRA has additional operational resilience expectation of credit unions with more than £10m in total assets (see paragraph 11.11) and credit unions with more than £50m in total assets (see paragraph 12.6).

18.14 The PRA also expects the nature of the CUSO to be taken into consideration, for example, the expectations in this chapter would not apply to CUSOs that provide trade association services only or to CUSOs which act as conduit only (ie allowing several credit unions to contract as a single entity. Such CUSOs would not perform any services itself or employ any staff).

18 Requirements and expectations on outsourcing for credit unions are set out in the Fundamental Rules, Chapters 10,11,13-17 in the Credit Unions Part of the PRA Rulebook, Chapters 10 – 12 of this supervisory statement, Information Gathering 2.2 and 3.3, Notifications 2.3 (1)(e) and the Allocation of Responsibilities 5.2(3), (4), and (6).