



7 October 2020

Dear Directors,

This letter should be read in conjunction with the email sent to Category 5 credit unions (CUs) on Thursday 10 September and the letter sent to all PRA-regulated credit unions, on Wednesday 8 April 2020.¹

We recognise and are sympathetic to the challenges that CUs across the UK are facing in the current environment. Our close engagement with the sector over the past months has been valuable in informing us of issues as they arise. Against this backdrop, we continue to emphasise the need for good governance and financial management at this time.

The objectives of this letter are to:

- reiterate messages on **engagement with the PRA and regulatory reporting**;
- confirm the **PRA's supervisory focus and priorities** for CUs in this period; and
- give detail of a **PRA rule modification to minimum provisioning requirements available to all consenting CUs** from Saturday 2 January 2021 until Saturday 31 December 2022.

Engagement with the PRA and regulatory reporting

We are committed to engaging with CUs on regulatory matters in a proportionate and practical way. However, we can only do this effectively with a full understanding of the problems that you are facing. As directors of regulated entities, you are obliged to be open, transparent, and honest with the PRA at all times.²

We also expect CUs to have adequate and proportionate financial management controls. A significant part of demonstrating these controls is the timely submission to the PRA of accurate financial data, by way of regular quarterly and annual regulatory returns.

To notify us of particular problems at your firm or if you are experiencing problems with the submission of returns, please use our mailbox address: prudential_creditunions@bankofengland.co.uk.

PRA supervisory focus and priorities

In past communications with the CU sector, we have consistently stressed the importance of sound governance, risk management, and general prudence. It is crucial that CUs are mindful of these principles during this period of stress.

¹ Copies of the letters can be found here: <https://www.bankofengland.co.uk/prudential-regulation/supervision/credit-unions>.

² Fundamental Rules 2.7: "A firm must deal with its regulators in an open and cooperative way and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice."

We remind CUs of their continuing and existing regulatory requirements as set out in the Credit Union Part of the PRA Rulebook. The PRA rules set out obligations with respect to credit risk management, credit control, record-keeping, and the collection of adequate management information.³

As lenders of primarily small, unsecured personal loans, CUs are all facing varying degrees of stress in loan collection and arrears management. We realise that as member-owned co-operatives, CUs will seek to balance their business practices and their members' needs. We understand that some CUs have changed their strategic approach to new lending and credit control in the light of these needs.

If CUs do make such changes, it is essential that Boards consider and accept the associated risks, and the potential financial impact in the short, medium, and long term, and ensure they have focused management information that allows them to measure the success of their approach. As in all areas of its business, a CU should act prudently and in the best interests of its members.

We would also stress the importance of a CU's cure rate as an indicator. The nature of PRA provisioning requirements, whether or not a CU consents to the modification of PRA provisioning rules (see below), means a CU's capacity to cure bad debts – particularly before they reach 12 months in arrears - is a key driver in terms of financial performance. Our analysis shows that CUs who engage with members whose loans are in arrears and get them paying again before the mandatory 100% provision hits at 12 months, have a far better chance of avoiding financial difficulty.

PRA Rule modification to minimum provisioning requirements

We have decided to publish a model direction modifying a PRA rule on minimum provisioning requirements. The modification will come into effect for all consenting CUs on Saturday 2 January 2021, and will be available until Saturday 31 December 2022. We have taken this decision due to the ongoing stress CUs face due to the Covid-19 outbreak and the importance of a CU's capacity to cure bad debts prior to 12 months, as outlined above.

The modification is identical in effect to a modification currently available to all CUs, which expires on Saturday 1 January 2021.⁴ Where CUs consent to the modification, minimum provisioning requirements for bad debt will be reduced to the rates set out below:

Percentage of the net liability to the CU of borrowers where the amount is:	<u>Rule 3.11 (unmodified)</u> A CU must make specific provision...of at least	<u>Modified Rule 3.11</u> A CU must make specific provision...of at least
more than 3 months in arrears	35%	20%
more than 6 months in arrears	60%	40%
more than 9 months in arrears	80%	60%
more than 12 months in arrears	100%	100%

³ In particular we refer CUs to 10.2 (<http://www.prarulebook.co.uk/rulebook/Content/Chapter/320155/06-04-2020>) and 16.3 (<http://www.prarulebook.co.uk/rulebook/Content/Chapter/320155/06-04-2020>)

⁴ Both the current modification and the one available from 2 January 2021 can be viewed here: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/authorisations/waivers-and-modifications-of-rules/modification-by-consent-to-rule-311-of-the-credit-unions-pra-rulebook-direction.pdf?la=en&hash=4DA4A9BAC887583A8F99994AEF93EE05F8CCE791>

CUs that have consented to the current modification must also consent to the new modification if they wish the modified rules to continue to apply to them after Saturday 1 January 2021. CUs wishing to use this modification should email prudential_creditunions@bankofengland.co.uk, confirming they are consenting to the modification, and giving the CU's name and Firm Reference Number. No further supporting information is needed. CUs can consent in advance of Saturday 2 January 2021, although the modification will not apply until that date. We will send a short confirmation email by return, and will publish a list of CUs consenting to the modification on the PRA's website. That list will be updated with the names of consenting CUs at regular intervals.

CUs should consider carefully whether they want this rule modification to apply to them, taking into account the profile of the membership, and the historic and current rates of arrears in the loan book. If taking up the modification, CUs should be mindful of the overarching PRA requirement on provisioning ('A credit union must make adequate provision for bad debts') and provision accordingly and appropriately.

For more information, see the FAQs in the annex to this letter.

Yours sincerely

CU Supervision team

Annex: FAQs – modification

What is a modification by consent?	The PRA has power under s138A of the Financial Services and Markets Act 2000 to direct that specific rules in the PRA handbook apply to certain firms with modifications. The PRA may only make such a direction if satisfied that: a) compliance by the particular firm with the unmodified rule would be unduly burdensome or would not achieve the purpose for which the rule was made; and b) the direction would not adversely affect the advancement of any of the PRA's objectives.
Which CUs does the modified rule apply to?	All CUs may consent to the modification, but the modified rule will only apply to those CUs that do in fact consent.
Which rule will be modified?	The model direction modifies Rule 3.11 of the PRA Rulebook Credit Union Part.
Do we (the CU) have to consent to the modification?	No, you do not have to consent to the modification. But to take advantage of the modification you do need to consent.
How can CUs consent to the modification?	To consent to, and so take advantage of, the modification, send a short email with your CU's name and Firm Reference Number to prudential_creditunions@bankofengland.co.uk . We will send you a short confirmatory email by return and PRA's website will give a list of CUs consenting to the modification.
What if we do not consent to the modification?	Should you decide not to consent to the modification, you will be subject to the rules in the PRA Rulebook Credit Union Part as they currently stand. In particular, you will need to make specific provisions for bad debts as set out in the unmodified Rule 3.11.
When does the modification start?	The modification will apply to consenting CUs from 2 January 2021. It will not apply to your CU until you consent to the modification.
How long does it last?	The modification lasts until 31 December 2022.