



The Board of Directors

[Marcela Hashim
Credit Unions Team]

October 2021

Dear Directors

PRA Annual Assessment of the Credit Union sector

Your firm is a part of a group made up of credit unions (CUs) with total assets above £15 million and/or with more than 10,000 members. This means that in addition to the individual assessment by your named supervisor once every two years, for which you receive feedback, we also carry out an annual assessment of your CU as part of a larger peer group. This has now been completed and this letter gives our findings.

This letter should be considered by all directors.

Covid-19 pandemic

We recognise that CUs across the UK continue to face a period of unprecedented operational and financial challenges. We have continued to collect monthly returns that allow us to analyse the impact of the pandemic on the sector and individual CUs, and to identify those most at risk. Each CU is different, and the level to which it is impacted by the current crisis will depend on its business model and membership. It is therefore crucial that the Board regularly monitors the prudential position, including compliance with key financial ratios, and key risks, and takes appropriate, timely action.

We are committed to engaging with CUs on regulatory matters in a proportionate way, which relies on CUs being open and transparent with the PRA. Fundamental Rule 7 states that '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'. If you become aware of any events that are likely to have an impact on your prudential position or ability to continue to offer your services to members, we expect you to notify the PRA as soon as reasonably possible, by contacting your named supervisor or emailing prudential_creditunions@bankofengland.co.uk.

Single Customer View (SCV) – frequent issues and self-verification portal

Where a CU is likely to have to close, an up-to-date and accurate Single Customer View (SCV) file is crucial for orderly resolution. While we continue testing CUs' SCV files, prioritising those where we have concerns about sustainability and/or viability, we expect all CUs, regardless of size, to undertake regular reviews and updates of their SCV data, and carry out testing of SCV files and procedures.

In reviewing SCV policies and procedures, CUs should consider the following:

- Can the SCV file be produced in the correct format with all the required fields (see [The Financial Services Compensation Scheme \(FSCS\) Guide to SCV](#))?
- Is the CU able to submit the SCV without an input from a third party and within the set time limit (24 hours)?
- Does the CU have documented SCV policy/procedures to ensure accuracy and consistency, and to minimise the reliance for submission on key individual(s)?
- Does the CU compare its SCV file to other management information, databases, and returns?
- How often does the CU review its members' details? How does it test their accuracy?
- Is SCV included in the supervisor/IA review?

The most frequent issues identified during the SCV testing over the last 12 months included (in order of frequency):

- missing mandatory data items;
- file format issues;
- ineligible depositors included in the main SCV file;
- duplicate entries (each depositor should be allocated a single SCV ID);
- balance issues;
- missing depositors; and
- exclusion file format issues.

In addition to full SCV testing, we continue to offer the CUs access to the FSCS self-verification portal, which allows them to test their SCV file at a time that suits them and to use the portal repeatedly as they address issues identified by the testing. Thirty of your peers have used the portal over the last 12 months and received comprehensive feedback, similar to the full testing process. We will generally ask you to use the portal prior to and around the time of your biennial visit, but please contact your named supervisor if you want to use the portal at any other time (the portal's capacity is currently limited, so there may be a delay between you submitting your request and using the portal).

Credit risk

While most CUs within this peer group have reported a gradual improvement in arrears over the last 12 months, with average arrears now at the pre-pandemic level, Boards should continue to closely monitor the impact of the pandemic on bad debts and the potential impact on their firm's financial position. This is even more important given that many CUs expect a deterioration in arrears in the second half of 2021.

CUs in this peer group should undertake proportionate scenario testing to obtain information and data that allows them to take timely and effective remedial action in order to manage and control the incidences of loan delinquency, impairment, and arrears, and thereby mitigate and minimise the risk of financial loss arising from provisions for bad and doubtful debts and write-offs.

Where the Board intends to increase its loan book through new products/types of loans or with the use of technology, it should recognise that it may require different skills and carry different risks. The Board should ensure that it has sufficient resources and systems and controls to mitigate these risks. Please ensure that you keep the PRA informed of any significant developments.

Capital requirements

The majority of the CUs in this peer group have a sizeable capital buffer above relevant minima, and the policy changes in force from March 2020 resulted in a greater degree of flexibility and removed some barriers to growth. However, the fast growth in shares combined with falling loan income have resulted in increased pressure on capital-to-assets ratios.¹

CUs in this peer group should consider/model a number of 'what-if' scenarios (eg further growth in shares, a slower recovery in lending, a larger-than-expected increase in arrears) in order to consider the likely impact on their future financial performance and identify trigger points for further action should the key indicators move beyond their Boards' agreed risk appetite.

Operational risk and resilience

Operational change notifications

In January 2021, we wrote to you with details of our expectations around notifying the PRA about material operational changes, eg replacement of a core banking system, change of third party service supplier, digital transformation programmes, or data centre/Cloud migration. When considering operational changes, the Board should ensure that it has appropriate governance, risk management, and mitigation in place for the change.

¹ Within this peer group, members' shares increased by more than 20% between March 2020 and June 2021, and loan income fell by c.4% in the same period.

Outsourcing

We additionally reminded you that where a CU outsources important operational functions, it remains fully responsible for all its obligations under the regulatory regime. The Directors should review any plans in the light of the requirements listed in Chapter 14 (Outsourcing) of the Credit Unions Part of the PRA Rulebook. Additionally, you may also wish to consider the PRA's [Supervisory Statement 2/21 'Outsourcing and third party risk management'](#).

Cyber

We continue to receive reports of cyber incidents in CUs, from cyber fraud to ransomware attacks. CUs should assume that operational/cyber incidents will happen, and have mitigating policies/procedures in place to ensure their system is resilient, ie can absorb shocks rather than contribute to them.

CUs should think about their particular business services, how these could be disrupted, and how they might need to adapt to ensure critical services can continue to be delivered through disruption, with a focus on contingency. The Board may wish to consider the following questions:

- Does the CU have a formally documented cyber security strategy and framework to deliver it?
- What level of knowledge and skills exists at the Board and SMT level?
- Do you understand the arrangements in place with all third party providers?
- Are hardware and software vulnerabilities proactively identified and documented?
- How is the user access to the CU system managed? Is it regularly reviewed?
- What are CUs' back-up arrangements?
- What measures do you have in place to ensure that parties with ongoing access are appropriately managed?
- Do you employ multiple layers of security?
- What cyber security training does the CU provide to volunteers and staff?
- What physical access controls does the CU have in place?
- Do you monitor for anomalous activity?
- Do you carry out penetration tests to identify vulnerabilities that may affect your system?
- Does your incident response plan include communications (including to members, where appropriate)?
- Have you tested recovery activities (including with critical third parties)?

Governance

Succession planning

Some of your peers told us that the last 12 months have made it more difficult to attract and retain new Board members and/or supervisors. However, a small number of large Category 5 CUs used the pandemic, with increased remote working and wider acceptance of technology, to their advantage, performing skills audits to identify gaps in the Board's knowledge, and taking a targeted approach to find members with relevant skills to fill those gaps. Good governance is fundamental to the safety and soundness of each CU. While the recruitment and retaining of volunteers possessing relevant skills is challenging, it is nevertheless vital so that the directors can continue to demonstrate that the CU is managed in accordance with the PRA's Fundamental Rule 3 ('A firm must conduct its business with due skill, care and diligence').

Next steps

As directors of a CU, you have personal and joint obligations to serve your members and to meet regulatory and legal requirements. In doing so, please consider the points set out above and act appropriately. The content of this letter has been shared with all UK trade bodies and CU auditors, and you may wish to discuss with them the points we have made.

If you have questions about the content of this letter, please contact your named supervisor or the PRA's Firm Enquiries Function on 020 3461 7000 / PRA.FirmEnquiries@bankofengland.co.uk.

Yours faithfully

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

Marcela Hashim
Credit Unions Team