Bank of England PRA

Please note: This letter has been prepared for the website. Square brackets show where this letter may differ slightly, along with formatting from those versions sent directly to firms.

Marcela Hashim
Senior Manager, Credit Unions Team

6 October 2023

Dear directors,

Prudential Regulation Authority (PRA) Annual Assessment of the Credit Union (CU) Sector

Following the changes described in our email dated 15 May 2023, your firm is part of a group of CUs with total assets up to £10 million (Peer Group 4B).

We recently held a Periodic Summary Meeting (PSM) for this Peer Group. The PSM meeting reviews the risk profile of the firms, challenges, and validates the medium to long-term supervisory strategy and approves the supervisory plan for the following twelve months. This letter sets out the key findings from our annual assessment and the actions we expect you to take.

Challenging macro environment

CUs across the UK continue to face a challenging business and operating environment, dominated by higher interest rates, inflation, and economic uncertainty. While higher interest rates may in the short to medium-term have a positive impact on returns from CUs' surplus funds, in some cases we have seen higher rates negatively impacting on CUs' ability to maintain expected levels of lending. Rising costs of living lead to increasing difficulties for borrowers, with corresponding increases in arrears.

CUs need to be resilient to a prolonged period of stress and take proactive steps to assess the implications of the evolving economic outlook on the sustainability of their business model. CU boards must continue to be forward-looking and to regularly monitor their prudential position to manage credit and interest rate risks and any emerging issues.

Corporate governance and succession planning

Good governance is fundamental to the safety and soundness of each CU. A number of closures over the past 12 months resulted from CUs being unable to recruit new volunteers with relevant skills and experience. Many of your peers report that it continues to be difficult to attract and retain new board members. We have seen cases where lack of an engaged and effective board of directors has led to a deterioration in the safety and soundness of CUs. CUs must comply not only with the PRA's rules, but also with their own registered rules and internal requirements for the composition of the board and key committees. Where the board is unable to implement an effective succession plan and faces key person risk, existing directors should consider the future of the business and the options available (such as a transfer of engagements or a solvent closure) and take appropriate action.

Liquidity

Benign economic conditions and low interest rates over the past decade have led to significant liquidity at many CUs. During the height of the pandemic, most CUs saw members' share balances and surplus funds continuing to increase despite other challenges faced by members.

The external environment has changed considerably over the past 12–24 months and the combined effect of reduced affordability for new lending applications and increasing returns on deposits outside the CU sector creates risk and stress the CU sector has not had to address in recent times. We have seen these risks crystallising. For example, we have seen instances where CU liquidity is negatively affected by unexpected member share withdrawals and/or poor management of investment maturity dates.

It is critical that CUs consider these potential issues when updating business plans and projections. Where a CU uses fixed-term investments, this should include reviewing their cash-flow and liquidity forecasts.

Supervisory statement

On 26 July 2023, we published policy statement (SS) 11/23 – Credit Unions: Changes to the regulatory regime[1] with the final policy for amending the CU Part of the PRA Rulebook and a new supervisory statement (SS) 2/23 – Supervising credit unions.[2] SS2/23 sets higher requirements and expectations for CUs that we assess as posing greater risk to the PRA's safety and soundness objective and clarifies the PRA's expectations of CUs in certain areas. We draw to your attention sections on Capital,

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[1] July 2023: **www.bankofengland.co.uk/prudential-regulation/publication/2023/july/credit-unions-changes-to-the-regulatory-regime**.

[2] July 2023: **www.bankofengland.co.uk/prudential-regulation/publication/2023/july/supervising-credit-unions**.

Liquidity Management, and additional requirements associated with the new allowed investment categories.

All boards should by **31 October 2023** review SS2/23, considering their business model, membership, and any additional activities, and agree a plan of how they will ensure ongoing compliance with the outlined requirements and expectations. This plan should be agreed at board level and evidenced appropriately.

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, you should consider the points set out above and to act appropriately. The content of this letter has been shared with UK trade bodies and CU auditors, and you may wish to discuss this with them.

If you have questions about the content of this letter, please contact **prudential_creditunions@bankofengland.co.uk**.

Yours faithfully,

Marcela Hashim
Senior Manager, Credit Unions Team

Appendix

Supervisory statement (SS) 2/23

Key changes applicable to CUs in this peer group:

Category	Details
Investments	Introduction of new investments categories and counterparty limits. We expect CUs investing in the new investment categories to comply with the new liquidity stress testing expectations.
Capital	We expect CUs to consider whether additional capital should be held above the minimum where the CU is exposed to certain risks.
Liquidity	Detailed expectations on the liquidity management policy statement and monitoring and reporting against internal targets and regulatory ratios.

Supervisory strategy for this Peer Group

Over the next 12 months, the PRA's CU team will continue to engage with the least resilient CUs and will focus on CUs with repeated poor practice, including in governance and regulatory reporting.

Operational change notifications

We remind boards of their obligation to notify us about material operational changes (by emailing **prudential_creditunions@bankofengland.co.uk**). Examples of when a notification would be appropriate include:

1. replacement of a core banking system;
2. change of third-party service supplier;
3. digital transformation programmes; and
4. 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.

Single Customer View (SCV) – self-verification portal

Where a CU is likely to close, an up-to-date and accurate SCV file is crucial for orderly resolution. Our testing of CUs' SCV files, prioritises those where we have concerns about sustainability and/or viability: however, all CUs, regardless of size, should undertake regular reviews and updates of their SCV data, and test SCV files and procedures.

We continue to offer CUs access to the Financial Services Compensation Scheme self-verification portal, which allows you to test your SCV file at a time that suits you.

Following the test, you will receive comprehensive feedback and can use the portal repeatedly to address any issues identified. We generally ask you to use the portal around the time of system changes or transfers of engagement or should the CU find itself in financial/operational difficulties. Please contact **prudential_creditunions@bankofengland.co.uk**. The portal's capacity is currently limited, so there may be a delay after you submit your request.