



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY

The Board of Directors

**Marcela Hashim**  
Credit Unions Team  
marcela.hashim@bankofengland.co.uk

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Dear Directors

### **PRA Annual Assessment of the Credit Union sector**

Your peer group is made up of credit unions with total assets of less than £15 million, and whose assets have grown by more than 30% and/or whose members have grown by more than 50% in the last financial year. While you are not subject to an individual review, we carry out an annual assessment of your credit union as part of a larger peer group. The 2018 assessment for this peer group has now taken place and we write to you with our findings.

### **Governance**

#### Growth and strategic planning

We expect boards of credit unions in this peer group to be able to demonstrate that any significant growth or introduction of new products or services are in line with the board's agreed risk appetite and its longer-term strategy. The board must agree realistic timescales for its 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 basic forward-looking stress testing of the business strategy to identify what the prudential impact would be if actual performance differed significantly from some of their targets— possible scenarios to analyse might include share growth greater than expected, lower loan than expected, a rise in base rates, possible changes to the benefit systems, or the potential impact of loss of external funding. This should comprise an analysis of (individual and combined) events including extreme but plausible scenarios.

#### Board's proactive role in maintaining good governance

All credit unions must ensure that their boards meet their obligations relating to prudent management and the monitoring and mitigation of risks. Credit unions must measure and monitor their compliance with key financial ratios and their underlying financial position and they must be able to demonstrate this is being done. Additionally, credit union boards must play an active part in maintaining good governance arrangements, including having and following appropriate policies and procedures relating to key person risk (for both staff and directors), conflicts of interest and internal audit arrangements.

#### Risk framework

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. Within the risk management framework, we expect the credit unions to build discrete and explicit quantitative measures and triggers, to which all the directors have signed up and that are consistent with and aligned to the risk tolerance levels of the Board as a whole. Without these quantified measures, there is a risk that credit unions inadvertently assume excessive levels of risk that result in financial losses exceeding the Board's risk appetite.

## Capital requirement

On 30 September 2018 the minimum capital requirement for all credit unions a) with total assets above £10m; b) with more than 15,000 members; or c) undertaking the additional activities of Additional Investments or Additional Lending increases to capital of at least 8% of total assets and a capital buffer at least equal to a further 2% of total assets, save in the event of a stress scenario in which case the buffer may be employed to absorb losses. Where a credit union's buffer falls below the 2% level, we expect the directors to notify the PRA immediately and then within a reasonable period to provide the PRA with a detailed plan for the restoration of its capital buffer. Further details relating to stress situations and use of the buffer can be found in the Supervisory Statement SS2/16<sup>1</sup>.

## **Single Customer View and orderly resolution**

### Single Customer View

Seven small credit unions failed since 1 August 2017 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 cases. While 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 and dealing with credit union defaults included incidences of credit unions submitting SCV file in the old file format (frequently due to credit unions not keeping their software up-to-date), credit unions being unable to submit the SCV Effectiveness Report, Marking Effectiveness Report and CoA Report<sup>2</sup> within 24 hours and only one individual (frequently a member of staff) being able to submit the file.

We expect the credit unions to undertake 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, accounts of inactive members, corporate accounts (ensuring that the accounts are classified correctly and that the credit union has beneficiary details) and correct extraction of members' details in line with the minimum address criteria.

### FSCS compensation sum

Where a credit union intends to accept deposits above the FSCS compensation sum (currently £85k), the credit union must notify the PRA in writing at least five business days prior to issuing non-deferred shares above this sum. Section 5 (Maximum deposit levels) of the Supervisory Statement SS2/16 details information required at the time of the notice. Should a credit union not satisfy the PRA that its acceptance of such a deposit would be prudent, the PRA may impose a requirement on the credit union preventing it from issuing non-deferred shares above the FSCS compensation sum. The PRA also expects the credit unions to be able to demonstrate how it communicates the details of the FSCS compensation limits to members.

### Financial difficulties

Should you be in financial difficulty we expect you to notify the PRA as soon as is reasonably possible.

## **Operational risk and resilience and cyber security**

Over the last two years, Credit Union Supervision has begun its coverage of the related areas of operational and cyber resilience. This activity is critical in the pursuit of the Bank of England's financial stability objective. As a part of this objective the Bank of England aims to improve the ability of the

<sup>1</sup> Supervisory Statement SS2/16 can be downloaded from [www.bankofengland.co.uk/prudential-regulation/publication/2016/the-prudential-regulation-of-credit-unions-ss](http://www.bankofengland.co.uk/prudential-regulation/publication/2016/the-prudential-regulation-of-credit-unions-ss)

<sup>2</sup> Available from <https://www.fscs.org.uk/about-fscs/single-customer-view/>.

financial services sector, including the Credit Union movement, to absorb the impact of an unexpected event while continuing to perform its most important activities for the UK economy.

In this context, Operational Resilience means, not only planning around specific, identified risks but also planning on the assumption that any part of a credit union's infrastructure could be disrupted. As such you should have plans in place designed to both cope during short term business disruptions and to then recover fully in the aftermath. Credit unions need to consider whether they have designed the organisation, people, processes and technology to adapt and ensure critical services can continue to be delivered through disruptions which could occur, whether the disruption is from an expected source or an unexpected one.

Of growing importance within the overall operational resilience theme is the challenge of cyber resilience. The cyber threat is particularly and peculiarly challenging and complex since it can hit companies at different levels through different vulnerabilities. Cyber-attacks can exploit gaps in process, or technology or people's skills and awareness.

Ransomware, targeted phishing campaigns (spear-phishing) and distributed denial of service attacks (DDoS) are only few of the many type of cyber-attacks which threaten organisations. There is no single solution for organisations to be cyber resilient. However, the success of these attacks can be reduced both through robust cyber security toolsets, staff/volunteer education and preparations for recovery from attacks.

#### Internal fraud

While the majority of the threats mentioned above originate externally, during the year the PRA became aware of a number of cases that involved fraud committed by either members of staff or directors. A number of these cases resulted in significant losses for credit unions, and ultimately in a number of credit unions closing. While all credit unions must maintain a policy of insurance for losses suffered by reason of fraud or other dishonesty of any of its officers or employees, any cover is subject to the credit union being able to meet insurer's minimum standards and being able to demonstrate that it had appropriate systems and controls in place to identify and mitigate the risks of internal fraud. This further highlights the importance of active involvement of directors, strong governance and constructive challenge at all levels within the credit unions, including Boards and senior staff.

#### **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. The content of this letter has been shared 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



Marcela Hashim  
Credit Unions Team