



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY

The Board of Directors

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Dear Directors

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

Your firm is a part of a group of credit unions (“CUs”) with total assets below £15m and fewer than 10,000 members. While you are not subject to an individual review, we carry out an annual assessment of your credit union as part of this group. This has now been completed and this letter gives our findings.

This letter should be considered by all directors.

### **Response to Covid-19 pandemic**

On 18 March and 8 April we wrote to all CUs, acknowledging the unprecedented operational and financial challenges caused by the pandemic, and outlining our supervisory focus and priorities (<https://www.bankofengland.co.uk/prudential-regulation/letter/2020/letter-to-credit-unions-on-covid-19>). Each CU is different, and the level to which it is impacted will depend on its business model and membership, so it is crucial that the Board regularly monitors the prudential position 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 and informing Supervision of any significant operational or prudential challenges. If you become aware of any events that are likely to 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 email to [prudential\\_creditunions@bankofengland.co.uk](mailto:prudential_creditunions@bankofengland.co.uk) or by telephoning the Firms’ Enquiries Function on 020 3461 7000.

### **Single Customer View (SCV) and orderly resolution**

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 procedure, we expect CUs to consider the following:

- A CU is obliged to notify the PRA of any material change to your SCV system (e.g. upon the introduction of a new IT system linked to the SCV system)?
- Can the SCV file be produced in the correct format with all the required fields (see <https://www.fscs.org.uk/globalassets/scv/2017-03-24-fscs-guide-to-scv---mar-2017-final.pdf>)?
- Is more than one individual at the CU able to run/ submit the SCV file?
- Do you compare your SCV file to other management information and databases?
- What process is in place to ensure that members’ contact details are up-to-date?

In addition to full SCV testing, CUs now have access to the FSCS self-verification portal, which allows them to test their SCV file at a time that suits them, and receive comprehensive feedback similar to the full testing process. The portal's capacity is limited, so if you would like to use it, please contact the Supervision team on [prudential\\_creditunions@bankofengland.co.uk](mailto:prudential_creditunions@bankofengland.co.uk).

## **Operational risk and resilience**

Before undertaking strategic initiatives to expand and develop new activities - especially online - it is essential to carry out a comprehensive operational risk assessment, ensuring appropriate and adequately robust systems and controls.

### Outsourcing

Where a CU outsources important operational functions, it remains fully responsible for all its obligations under the regulatory regime. Directors cannot delegate their responsibilities, and the CU must retain the necessary expertise to supervise the outsourced functions.

All CUs using or considering outsourcing should review their arrangements in the light of the requirements listed in Section 14 (Outsourcing) of the Credit Unions Rulebook Part ([www.prarulebook.co.uk/rulebook/Content/Part/320139/](http://www.prarulebook.co.uk/rulebook/Content/Part/320139/)). This includes demonstrating that the CU is able to terminate the arrangement where necessary without detriment to the continuity and quality of its provision of services to members. We have seen instances where this has not been the case, which poses a risk to CUs and their members.

While reviewing/ considering your outsourcing arrangements, you may wish to consider PRA's Consultation Paper 30/19: Outsourcing and third party risk management (<https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2019/cp3019.pdf>).

### Operational resilience

We are seeing an increase in the number of operational and cyber incidents in CUs. Operational resilience means planning, not only around specific and identified risks, but also assuming that any part of the CU's infrastructure could be disrupted. We expect CUs to assume that operational/ cyber incidents will happen, and to have mitigating policies/ procedures in place to ensure their system is resilient, i.e. 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 should set their impact tolerance limits - points at which any further disruption would threaten financial stability, safety and soundness or consumer protection. CUs can strengthen their resilience by setting, monitoring and testing impact tolerances for key business services to inform existing and new strategies. While the responsibility lies with the Board, the ownership will generally be shared across the whole CU.

Questions we would expect CUs to consider in reviewing operational resilience include:

- What are the risk thresholds for operational resilience and how are these documented and monitored?
- What are the key assets that the CU is trying to protect?
- Does the CU document the core systems critical to the operation of the business?
- How are external dependencies and risks identified and managed?

We expect CUs to notify the PRA as soon as practically possible of any significant operational or cyber incidents or events that may impact on continuity of service as soon as is reasonably possible on [prudential\\_creditunions@bankofengland.co.uk](mailto:prudential_creditunions@bankofengland.co.uk) or the Firms' Enquiries Function on 020 3461 7000.

## Prudent management

All CU Boards must meet their obligations relating to prudent management and the monitoring and mitigation of risks. CUs must be able to demonstrate that they measure and monitor compliance with key financial ratios, including deterioration in credit quality, with a view to prompt remedial action.

### Capital requirements

On 13 March 2020 the PRA published Policy Statement 6/20 – Credit Unions: Review of the capital regime which:

- a) reduced the minimum capital requirement for CUs in this peer group undertaking certain additional activities, with more than 5,000 members, or CUs with total assets above £10m; and
- b) introduced the expectation (for CUs with a capital to assets ratio in the 3-5% range) of further engagement with the PRA. While dealing with these CUs, the PRA is committed to a flexible and proportionate supervisory approach, engaging with affected CUs on an individual basis dependent on their circumstances. The PRA would also encourage affected CUs to engage with trade bodies.

### Capital – Modification (Bad debt provisioning)

On 8 April 2020 the PRA invited all CUs to consent to a modification of Rule 3.11. This reduces the minimum provisioning requirement for bad debt in accordance with the direction available from the Waivers and modification page (<https://www.bankofengland.co.uk/prudential-regulation/authorisations/waivers-and-modifications-of-rules>). The letter explaining the modification and how to consent is available on (<https://www.bankofengland.co.uk/prudential-regulation/letter/2020/letter-to-credit-unions-on-covid-19>). The modified rule only applies to CUs that consent. We encourage all CUs to review the letter and attached FAQs.

### Calculation of regulatory capital

Our 2019 PSM letter referred to issues with CUs' treatment of bad debt and bad debt provisions, resulting in financial difficulty. That feedback is still relevant and we encourage CUs to refer to it if in doubt about its provisions and/ or rescheduling.

We have noted some further issues impacting on CUs' capital position.

Revaluation reserves: Section 8.2(6) of the PRA Credit Unions Rulebook Part sets conditions for revaluation reserves to be included in the calculation of regulatory capital. It explains how and how often (at least every five years) a property must be valued. Section 8.3 of the PRA Credit Unions Rulebook Part restricts the amount of the revaluation reserve to 25% of the CU's capital which means that some CUs may not be able to include all of their revaluation reserves (or in some instances any of them) in calculating regulatory capital. CU Boards should review these rules before including revaluation reserves in their regulatory capital.

Subordinated loans: Section 8.2(5) of the PRA Credit Unions Rulebook Part sets conditions for subordinated debt to be included in the calculation of capital. Instances where the subordinated loan does not qualify include, for example, a loan becoming repayable within the first five years and/ or the loan being conditional on the provision of certain services/ monitoring by a third party.

Where the Board is unsure whether a particular reserve or subordinated loan counts towards regulatory capital, you may wish to discuss this with your auditor, or trade body, or contact the PRA's Firms Enquiries Function on [prudential\\_creditunions@bankofengland.co.uk](mailto:prudential_creditunions@bankofengland.co.uk) or 020 3461 7000.

## **Governance**

### Financial difficulties

If your CU is in financial difficulty, we expect you to notify the PRA as soon as possible by emailing [prudential\\_creditunions@bankofengland.co.uk](mailto:prudential_creditunions@bankofengland.co.uk) or telephoning the Firms' Enquiries Function on 020 3461 7000.

### Succession planning

We expect the Board to take an active role in succession planning to ensure the CU can identify, attract and retain directors with relevant skills. CUs must comply not only with PRA requirements, but also with their own rules' requirements for the composition of Board and key committees. Where the Board is unable to attract a sufficient number of active directors to continue running the CU, existing directors must consider the future of the CU and take appropriate action. If you are in that situation, you should contact the PRA to discuss the various options available to you. You may also wish to speak to your trade body.

## **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, we expect you to consider the points set out above and to 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 questions about the content of this letter, please contact the PRA's Firm Enquiries Function on 020 3461 7000 / [PRA.FirmEnquiries@bankofengland.co.uk](mailto:PRA.FirmEnquiries@bankofengland.co.uk).

Yours faithfully



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