BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Agenda

- Publications
- Background
- The framework and requirements
- Matrices
- Other changes
- Credit Union supervision
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Publications

- On 1 February 2016, we published:
  - Policy statement 2/16;
  - Supervisory statement 4/16; and
  - Credit Union Rulebook Part – effective from 3 February 2016

Background to changes (1/2)

- As it stood, CREDS was not well-suited to developments in the credit union sector which see the adoption of more complex business models. We have therefore completed a full revision following CP22/15.

- CREDS contained dual-designated provisions currently 'shared' with the FCA. These needed to be defined as solely-prudential requirements and simultaneously removed from the FCA Handbook; purely conduct-related provisions also needed to be removed from the PRA rules.

- The review fulfilled a commitment given by PRA senior management to Northern Ireland credit unions to review the investment rules 'inherited' from the FSA.

Background to changes (2/2)

- We sought to put in place a framework that is:
  - flexible, such that it can accommodate the smallest institution and the largest;
  - adaptable to a range of existing and potential business models without the need for ad hoc revision;
  - respectful of internationally-recognised best practice for credit union management and supervision; and
  - reflective of the co-operative character of credit unions so that boards are genuinely accountable to their members for significant decisions that affect their interests.

- The majority of credit unions will not be materially affected by the proposed changes.
  - Most operating a basic 'savings and loans' business model will still have either a 3% or a 5% capital/assets requirement and all will have to meet the Fundamental Rule that implicitly requires them to have their Single Customer View file in good order and readily available to the Financial Services Compensation Scheme.

The framework and requirements (1/4)

- The old framework
  - Version one as default, relatively low limits on lending, investment term, borrowing.
  - Version two on application – limits are higher.
  - But inflexible one-off process that does not take account of credit union's own situation.

- The new framework.
  - Credit unions choose the activities they want to pursue.
  - Additional requirements tailored to the particular activity chosen.
  - Requirements proportionate to activity and level of activity undertaken.
  - No regulatory application or permission.

The framework and requirements (2/4)

- The choice for credit unions
  - To change or not to change.
  - Not for the regulators to direct you one way or another.
  - For smaller credit unions pursuing traditional credit union services, little or no change in requirements.

- Board responsibility.
  - Flexibility for you, but also responsibility.
  - Success of credit union, however that might be measured, is the responsibility of the board and senior management (not the PRA).

The framework and requirements (3/4)

- The four additional activities are:
  - Mortgage business
    - Additional permissions required. Significant conduct framework.
  - Lending
    - Limited to £15,000 + attached shares, five years unsecured, ten years secured.
    - “Additional” – 1.5% of total shares + attached shares, ten years unsecured, 25 years secured
  - Investment
    - Limited to one year term to maturity.
    - “Additional” – five year term as a maximum as long as product is capital-protected.
  - Transactional accounts
    - *“An account which is regularly used by a member respectively for the receipt and disbursement of funds from and to third parties.”*

The framework and requirements (4/4)

- The requirements:
  - Capital - 3%, 5% and 10%, but size isn't everything.
  - Capital – 8% core capital requirement, 2% buffer.
    - Buffer referred to in rules and supervisory statement.
    - Applicable for mortgages, lending and investment, but does not apply to transactional accounts.
    - Transitional provision.
  - Compliance with 10.3
    - Financial risk management policy statement.
    - *"A credit union carrying out any additional activity must…ensure that its governing body monitors and assesses the risk associated with the carrying on of such activities on at least a monthly basis."*
    - The ratios and the supervisory statement.
  - Recording investment decisions

Matrix 1: **Basic savings and loans model credit union (CU)**

Comparison of the previous and current prudential requirements (changes highlighted in blue)

<table>
<tr><th></th><th colspan="4">Previous requirements</th><th colspan="4">Current requirements[1*]</th></tr>
<tr><td></td><td>Version One credit union with up to 5,000 members and assets up to £5 million</td><td>Version One credit union with more than 5,000 members and/or assets above £5 million but with up to 10,000 members and assets up to £10 million</td><td>Version One credit union with more than 10,000 members and/or assets above £10 million</td><td>Version Two credit union</td><td>Credit union with up to 5,000 members and assets up to £5 million</td><td>Credit union with more than 5,000 members and/or assets above £5 million but with up to 15,000 members and assets up to £10 million</td><td>Credit union with more than 15,000 members and/or assets above £10 million</td><td>Version Two credit union</td></tr>
<tr><td>Capital</td><td>3%</td><td>5%</td><td>8% risk adjusted capital[2*]</td><td>8% risk adjusted capital</td><td>3%</td><td>5%</td><td>8% + 2%[3*]</td><td rowspan="7">n/a</td></tr>
<tr><td>Liquidity</td><td colspan="4">5% (but not below 10% on two consecutive quarters)</td><td colspan="3">10%</td></tr>
<tr><td>Borrowings</td><td colspan="3">20%</td><td>50%</td><td colspan="3">20%</td></tr>
<tr><td>Share limit</td><td colspan="4">Greater of £15,000 or 1.5% of total non-deferred shares</td><td colspan="3">Greater of £15,000 or 1.5% of total non-deferred shares[4*]</td></tr>
<tr><td>Lending limit - term</td><td colspan="3">Unsecured: 5 years, Secured: 10 years</td><td>Unsecured: 10 years, Secured: 25 years</td><td colspan="3">Unsecured: 5 years, Secured: 10 years</td></tr>
<tr><td>Lending limit - amount</td><td>Capital below 5%: £7,500 in excess of member's shares; otherwise £15,000 in excess of member's shares</td><td colspan="2">£15,000 in excess of member's shares</td><td>1.5% of total non-deferred shares</td><td>Capital below 5%: £7,500 in excess of member's shares; otherwise £15,000 in excess of member's shares</td><td colspan="2">£15,000 in excess of member's shares</td></tr>
<tr><td>Provisions for bad and doubtful debt</td><td colspan="4">Specific: 35% of the net liability 3-12 months in arrears + 100% of the net liability more than 12 months in arrears
(with guidance set at 60% of the net liability 6-9 months in arrears + 80 % of the net liability 9-12 months in arrears)
General: 2% of the net liability not covered by the specific provision</td><td colspan="3">Specific: 35% of the net liability 3-6 months in arrears, 60% of the net liability 6-9 months in arrears + 80 % of the net liability 9-12 months in arrears + 100% of the net liability more than 12 months in arrears
No minimum general provisions</td></tr>
</table>

*1 Requirements for CUs that do not undertake any of the additional activities. For requirements applicable to CUs undertaking any of the additional activities, please Matrix **2**.

*2 Risk adjusted capital = capital + provision for bad and doubtful debt – minimum specific provision for bad and doubtful debt

*3 8% capital + 2% capital buffer

*4 Notification requirement for amounts above the limit on the maximum compensation sum payable by the Financial Services Compensation Scheme (FSCS)

Matrix 2 **– Credit unions undertaking additional activities**

Ratio	**Additional investments**	**Additional lending**	**Mortgages**	**Transactional accounts**	**Indicative ratio**
Capital as percentage of *total assets*	**Y**	**Y**	**Y**		**10%***
Credit union's *borrowings* as percentage of *total asset*	**Y**	**Y**	**Y**	**Y**	**≤5%**
Total shares as percentage of *total assets*	**Y**	**Y**	**Y**	**Y**	**≥70% and ≤90%**
Total *bad debt* written off as percentage of *total loans*		**Y**	**Y**	**Y**	**≤10%**
Net assets as percentage of sum of *total shares* and *juvenile deposits*		**Y**	**Y**	**Y**	**≥105%**
Bad debt (more than three *months* in arrears) as percentage of *total loans*	**Y**	**Y**	**Y**	**Y**	**≤20%**
Non-earning assets as percentage of *total assets*	**Y**	**Y**	**Y**	**Y**	**≤10%**
Net zero cost funds as percentage of *non-earning assets*	**Y**	**Y**	**Y**	**Y**	**≥200%**
Loan income over 12 *months* as percentage of *total loans*		**Y**	**Y**	**Y**	**≥6%**
Net loans as percentage of *total assets*			**Y**	**Y**	**Deliberately left blank**

* This ratio is mandatory

Other changes

- Senior Managers Regime
- Single customer view (SCV) – December 2016
  - Electronic SCV for all
  - Time limit reduced to 24 hours
- Reporting
  - Consultation
  - Electronic reporting

Credit unions supervision

- Credit unions with total assets above £40m
  - Named supervisor
  - Annual assessment

- Credit unions with total assets between £15m and £40m
  - Individual monitoring by supervisor
  - Visit in 2016/17

- Credit unions with total assets up to £15m
  - Returns
  - SCV
  - Notifications of significant events with potential prudential impact

Contact details

- Website (http://www.bankofengland.co.uk/creditunions)

- General queries: Firm Enquiries Function (PRA.FirmEnquiries@bankofengland.co.uk / 020 3461 7000)

- Returns (creditunionreporting@bankofengland.co.uk / 020 3461 7000)