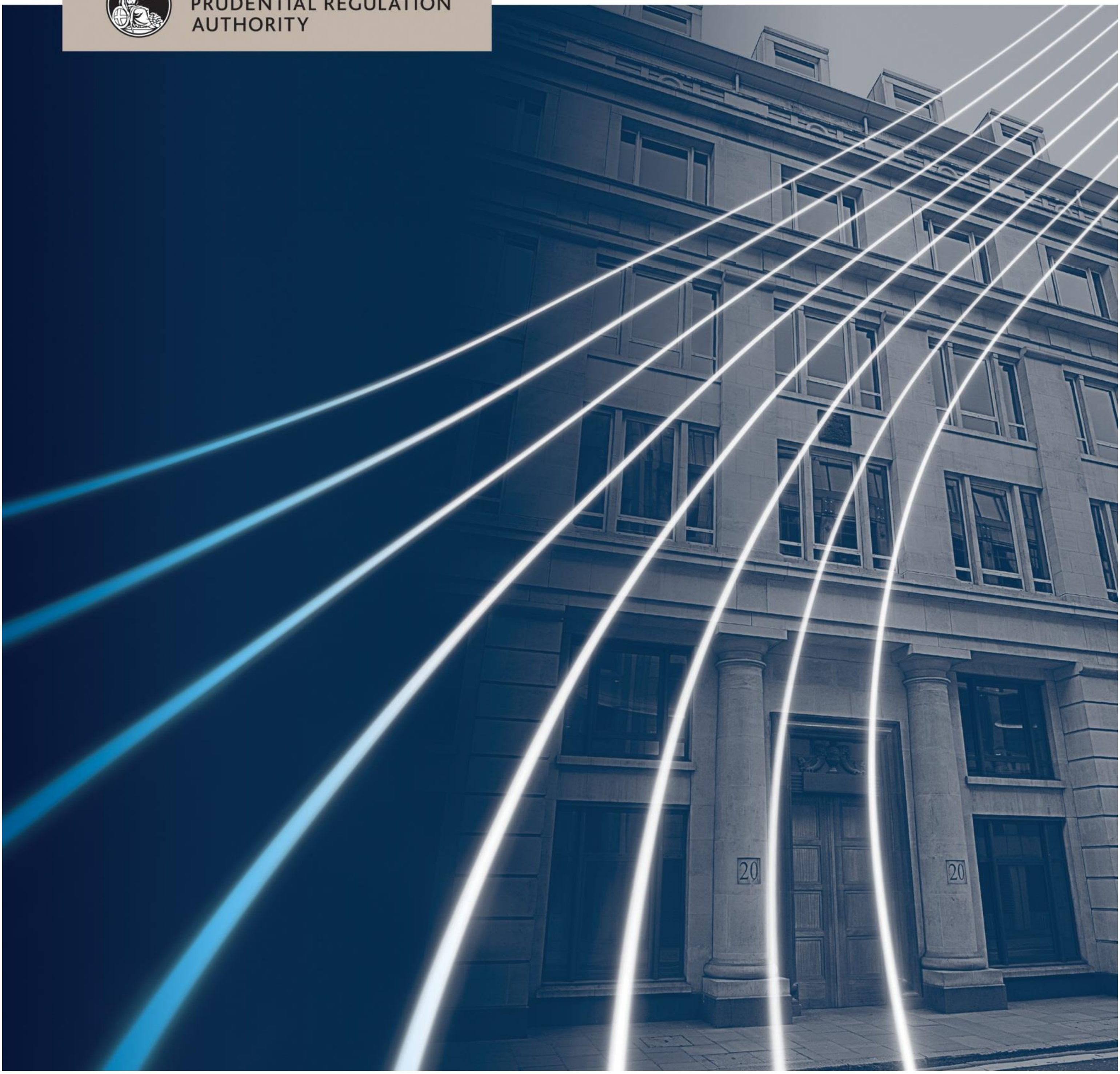
Policy Statement | PS6/20

Credit unions: Review of the capital regime

March 2020

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY



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Prudential Regulation Authority | 20 Moorgate | London EC2R 6DA

Contents

1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 28/19 'Credit unions: Review of the capital regime'.[1] It also contains the PRA's final policy, as follows:

- amendments to the Credit Union Part of the PRA Rulebook (Appendix 1); and
- the updated Supervisory Statement (SS) 2/16 'The prudential regulation of credit unions' (Appendix 2).

1.2 This PS is relevant to all UK credit unions.

Background

1.3 In CP28/19 the PRA proposed:

- for credit unions with more than £10 million of total assets, to provide a greater degree of flexibility and remove barriers to growth by replacing the current regime with a 'graduated rate' approach and removing the 2% capital buffer;
- to reduce complexity in the capital regime by removing the association between credit union activities/membership size and capital requirements, and to address the risks posed by these factors by other means; and
- new expectations in SS2/16 in relation to credit unions with a capital to assets ratio (CAR) in the 3-5% range, in which a credit union with a CAR below 5% should be prepared to engage more fully with the PRA.

Summary of responses

1.4 The PRA received 40 responses to CP28/19. 36 respondents were fully supportive of the PRA's proposals, although some of these respondents asked for clarification on a number of points. Four respondents did not support some or all of the proposals. The PRA provides feedback to requests for clarifications and objections to the proposals in Chapter 2.

1.5 A number of respondents made reference to matters outside the scope of the consultation and, in some cases, outside the PRA's remit. The PRA sets out these matters in Chapter 2.

Implementation

1.6 The changes in this PS take effect from Monday 16 March 2020.

1.7 The policy set out in this PS has been designed in the context of the UK's withdrawal from the European Union and entry into the transition period, during which time the UK remains subject to European law. The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework at the end of the transition period, including those arising once any new arrangements with the European Union take effect.

1 October 2019. https://www.bankofengland.co.uk/prudential-regulation/publication/2019/credit-unions-review-of-the-capital-regime.

1.8 The PRA has assessed that the policy would not need to be amended under the EU (Withdrawal) Act 2018 (EUWA). Please see PS5/19 'The Bank of England's amendments to financial services legislation under the European Union (Withdrawal) Act 2018'[2] for further details.

2 Feedback to responses

2.1 Before making any proposed rules, the PRA is required by the Financial Services and Markets Act 2000 (FSMA) to have regard to any representations made to it, and to publish an account, in general terms, of those representations and its feedback to them.[3]

2.2 The PRA has mapped the responses received to its consultation in line with the headings used in CP28/19.

Summary of the current and proposed capital requirements for credit unions

2.3 The majority of responses were supportive of the PRA's proposals.

2.4 Some of the respondents, while supportive of the proposals, asked the PRA to continue to keep the policy under review and expressed the view that introducing a risk-weighting regime for credit unions may be prudent in the longer term. The PRA confirms it continues to monitor the appropriateness of the capital regime on an ongoing basis.

2.5 One respondent suggested that the PRA set out in more detail its expectations for credit unions that experience a reduction in their capital requirements following implementation of this policy. The PRA's expectations of credit unions and their capital management are set out in the Credit Unions Part of the PRA Rulebook and SS2/16. The PRA expects credit unions to act prudently and in the best interests of their members.

2.6 One respondent requested clarity from the PRA that credit unions would not be disadvantaged by the interpretation of accountancy standards as they might relate to the introduction of these requirements. Credit union boards retain the flexibility to hold capital over and above the minimum requirements despite the changes being introduced. The interpretation of accounting standards will not affect this.[4]

2.7 The respondents that did not support the proposals made the following separate suggestions – that:

- a 3% leverage ratio should be applied to all credit unions, in order to facilitate expansion;
- the PRA should adopt a 6% CAR minimum requirement for credit unions with less than £5 million total assets;
- the PRA should introduce a sliding scale formula for calculating capital requirements rather than tiering the capital requirements; and
- capital requirements discriminate between the characteristics of a credit union's membership. The PRA has interpreted this suggestion as a request for a risk-weighted, or at least risk-based, approach to setting capital.

2 April 2019: https://www.bankofengland.co.uk/paper/2019/the-boes-amendments-to-financial-services-legislation-under-the-eu-withdrawal-act-2018.

3 Sections 138J(3) and 138J(4) of FSMA.

4 Credit Unions 8.1 states: A credit union (see definition: http://www.prarulebook.co.uk/rulebook/Glossary/FullDefinition/52110/30-01-2020) must have adequate capital taking into account the nature, scale and complexity of its business.

2.8 Having considered these responses, the PRA has decided not to make changes to the policy set out in CP28/19 in these areas. The aim of the policy as set out in the CP was to support expansion in the credit union sector while ensuring that straightforward, prudent and proportionate requirements are maintained for smaller credit unions. In CP28/19 our cost benefit analysis showed that the policy changes can reduce barriers to expansion, and feedback from individual credit unions and trade bodies in their responses to this CP has been supportive in this regard.

Proposals relating to credit unions with less than £5 million in total assets

2.9 36 responses were fully supportive of the PRA's proposals.

2.10 One respondent asked that the PRA consider amending the proposed text in paragraph 2.6 of SS2/16 to include amalgamation and transfer as options alongside the closure of the credit union where it no longer has a viable future. The PRA has considered this suggestion and has amended the wording to paragraph 2.6 in SS2/16 in line with this suggestion (see Appendix 2).

2.11 24 respondents asked for more clarity on the form of engagement that the PRA will expect from credit unions with a CAR in the 3-5% range, and whether the PRA could leverage work already undertaken by trade bodies. Having considered the feedback, the PRA has decided to maintain the wording of the draft text. The CP set out the PRA's proposed expectations rather than a prescriptive set of actions. The PRA considers this to be consistent with the PRA's supervisory approach as set out in the Credit Unions Part of the Rulebook and SS2/16. The PRA is committed to a flexible and proportionate supervisory approach, engaging with affected credit unions on an individual basis dependent on their circumstances. Subject to the permission of the credit unions in question, the PRA will engage with trade bodies as those bodies work to support their members. Regulatory responsibilities and obligations, of course, remain with the particular credit unions in such cases.

2.12 Two respondents suggested that the PRA go further than the approach set out in CP28/19 and implement a more prescriptive approach that obliged 'weak' credit unions to undertake a form of proactive resolution planning. The PRA already engages with smaller credit unions in financial difficulty on potential recovery and/or merger options. It does not consider that it would be appropriate, proportionate or cost-effective to put in place formal, prescriptive resolution planning for smaller credit unions.

Responses not directly related to the CP text

2.13 The PRA also received responses on issues that were not directly related to the proposals in CP28/19:

- one respondent made references to reforming certain regulatory ratios specified as guidance within the SS. The PRA will continue to review the appropriateness of its rules and guidance on an ongoing basis; and

- one respondent sought clarity on how a number of other capital rules relating to interim dividends and building reserves would work within the new framework. The PRA did not propose changes to other capital rules, even where these are binding above the proposed capital requirements, in order to support sector resilience. The PRA will continue to expect credit unions to meet all requirements.

2.14 One respondent raised questions in legislative areas that the PRA considers to be outside of its remit, and has not responded to. These questions concerned the:

- availability of credit union accounts at Companies House;
- process for approving the issuance of interest-bearing shares;
- insolvency regime of failed credit unions; and
- cap on the interest rate that can be charged by credit unions.

Appendices

1	**PRA RULEBOOK: NON CRR FIRMS: CREDIT UNIONS INSTRUMENT, available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2019/credit-unions-review-of-the-capital-regime**
2	**SS2/16 'The prudential regulation of credit unions', available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2016/the-prudential-regulation-of-credit-unions-ss**