



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

PRISM Supervisory Commentary 2019

April 2019

Registry of Credit Unions

Contents

1. Foreword	3
2. Executive Summary	4
3. Methodology	7
4. Overview of PRISM Risk Assessment Findings.....	9
5. Governance Risk.....	10
6. Operational Risk.....	18
7. Credit Risk.....	25
8. Strategy/Business Model Risk.....	32
9. Capital, Market and Liquidity Risk.....	39
Appendix 1.....	41

1. Foreword

Strengthening credit union core foundations across governance, risk management and operational capabilities is a key focus of our supervisory strategy. The purpose of the PRISM Supervisory Commentary is to inform the sector on the nature of issues identified arising from our 2018 supervisory engagements. In this, its third edition, the commentary sets out evidence-based findings in key risk areas and outlines our associated supervisory expectations. This is designed to support credit union boards and management teams in reviewing and embedding improved governance, risk management and operational frameworks.

As supervisors, we apply greatest intensity and depth of engagement to those larger credit unions with elevated risk profiles. To align to our supervisory expectations, the leadership of large credit unions must demonstrate that their firms are effectively governed, professionally managed and staffed by competent, capable people who appreciate and prudently manage risks, while successfully meeting members' product and service expectations. For other credit unions, we adopt a proportionate approach reflecting nature, scale and complexity and expect that the board can demonstrate that all material risks are effectively managed to at least the minimum regulatory standard.

Across each category of risk addressed in the report, while we note varying levels of improvement in individual credit unions, we also see evidence of continued weaknesses in a number of credit unions in fundamental areas including in governance, credit underwriting, operational capability and business model strategy. This is concerning, particularly at this time as credit unions deal with an increasing range of internal and external challenges that go to the heart of their business models. Technology is rapidly changing the way that customers interact with financial services institutions and the way in which these institutions interact with their customers. Speed of decision making, electronic marketing and digitised distribution channels are now a core expectation. It is surprising therefore that IT strategy as a key enabler of business model change, is not given greater prominence in many of the strategic plans that we see.

The risk profile of many credit unions is increasing due to growing business complexity, as credit unions seek to expand their business models in response to their commercial challenges. The responsibility rests with boards and management to ensure that their governance, compliance and risk management frameworks continue to be able to support business model change. This is a business imperative for credit unions, as unmanaged risk can negatively impact credit union performance and member confidence.

The findings set out in this report should be considered by all credit unions in the context of assessing the adequacy of their own risk management framework and determining appropriate actions to mitigate risks identified so that they are better placed to deliver sustainability and serve members' needs.



Patrick Casey

Registrar of Credit Unions

April 2019



2. Executive Summary

The PRISM Supervisory Commentary 2019 provides an overview of seven risk categories of the PRISM¹ framework where risk issues were identified in credit unions. The commentary is based on 621 individual risk issues, identified by the Registry of Credit Unions (RCU) across these risk categories during our PRISM supervisory engagements. These risk issues form the basis for 103 Risk Mitigation Programmes (RMPs) issued to credit unions between January and October 2018 on foot of our supervisory engagements.

Our analysis of risk issues identified during these engagements has been collated into a number of key themes across governance, credit, operational capability and strategy/business model risk, which are summarised below.

In line with previous editions of the PRISM Supervisory Commentary, we set out our supervisory expectations across the PRISM risk categories. The appendix sets out two examples of successful risk mitigation programmes implemented by credit unions. These are cases where risk issues were identified during supervisory engagements, which were subsequently remediated through the implementation of an RMP resulting in stronger governance, risk management and compliance frameworks and improved operational capabilities in the two credit unions concerned. The PRISM Supervisory Commentary is intended to be a useful reference tool for all credit union boards and management teams to support the enhancement of their governance, risk management and operational frameworks.

Governance Risk

The ultimate responsibility for the control, direction and management of the credit union vests with the board of directors. We are encouraged to see examples of effective governance where the board can demonstrate strong leadership and oversight of the credit union including board ownership of risk management and mitigation to ensure the credit union addresses its specific risk vulnerabilities. However, we continue to identify fundamental governance risk issues during our supervisory engagements with credit unions across all asset classifications.

Key governance risk issues identified include:

- Weaknesses in the risk management and compliance frameworks within credit unions, with evidence of failure to adequately resource these key functions identified in a number of credit unions;

¹ The Probability Risk and Impact System (PRISM) is the Central Bank's risk-based framework for the supervision of regulated firms. PRISM System outlines the probability risk categories used by supervisors to assess a credit union's risk probability. Further detail can be found in the '[PRISM Explained](#)' Guidance issued in February 2016.

- Inadequate risk management and compliance reporting to the board of directors commonly identified during supervisory engagements; and
- Lack of effective board oversight of the risk management, compliance and internal audit functions evident, with lack of challenge by boards on the reports from these functions, lack of follow-up on issues identified and lack of review of the performance of these functions noted during supervisory engagements across credit unions of all asset classifications.

Credit Risk

Credit risk remains a key area of focus during our supervisory engagements with credit unions. We have seen positive trends in the areas of new lending and reduced arrears for credit unions, as highlighted in Issue 4 of the *'Financial Conditions for Credit Unions'*, published in December 2018. We identified fundamental weaknesses in credit underwriting across all asset classifications during our 2018 supervisory engagements. It is particularly concerning to see the issues below present in larger credit unions expressing a desire to move into longer term, more complex lending strategies.

Key credit risk issues identified include:

- Evidence of poor underwriting identified, including failures to assess accurately the repayment capacity of members and inaccuracies in calculating debt-to-income ratios;
- Examples of weak oversight of the credit function, including divergence in credit practices from that of stated credit policies; and
- Lack of a clear rationale to support the issuance of new lending in some cases.

Operational Risk

Operational risk continues to remain at an unacceptably high level as evidenced by our onsite testing and sampling during supervisory engagements with credit unions. Identified weaknesses in the key functions of risk management, compliance and internal audit appear to have a knock-on effect in operational risk areas with deficiencies in core processes noted by supervisors, which were not identified by the internal audit or risk management functions and were not effectively remediated as a result.

Key operational risk issues identified include:

- Evidence of operational weaknesses related to poor internal controls and processes;
- Deficiencies in anti-money laundering processes; and
- Inadequate segregation of duties within the credit union.

Growing complexity increases risk vulnerabilities for credit unions, including via information technology and other outsourcing arrangements and requires robust operational risk frameworks to identify and mitigate risks effectively.

Strategy/Business Model Risk

It is evident from our supervisory engagements during 2018 that maintaining a clear strategic focus remains a challenge for some credit union boards. In some cases, strategic planning is being treated as a compliance exercise by boards and management, as opposed to a central input to determining future business model sustainability supported by analysis, consideration and discussion on meaningful business model transition by boards.

Key strategy/business model risk issues identified include:

- Overall quality of the strategic plan presents a challenge for some credit unions with assets of at least €40m and less than €100m, in particular, with examples of boards failing to identify and address the challenges faced by the credit union as part of this process; and
- Evidence of viability concerns in a number of cases across smaller credit unions, with the risk that the credit union will not be able to generate a surplus in the short to medium term not being recognised and addressed through the strategic planning process.

Viability challenges for smaller credit unions may necessitate alternative strategies, including the need to engage with larger, more stable credit unions in order to ensure continuity in the provision of services for members.

In summary, it is encouraging to note evidence of improvements in governance frameworks in some credit unions. However, we continue to identify fundamental issues across governance, credit, operational risk and business model risk in many credit unions. These basic shortcomings are concerning, particularly given the stated desire of the sector to evolve the business model through the provision of new products and services including the provision of house loans. The strengthening of core foundations in the areas of governance, risk management and operational capability, in order to address key risk vulnerabilities, remain essential to enable prudent business model transition in credit unions.

3. Methodology

Risk-based supervision, carried out through our PRISM framework is fundamental to the execution of the Central Bank's statutory mandate² to administer the system of regulation and supervision of credit unions with a view to ensuring protection by credit unions of the funds of its members, as well as the maintenance of the financial stability and well-being of credit unions generally. PRISM enhances our ability to deliver judgement-based, outcome-focused supervision for the sector.

Supervisory Proportionality

RCU has communicated³ to the sector that in order to deliver on *supervisory proportionality*, our engagement approach had been further refined to differentiate on a proportionate basis between small and medium credit unions (under €100m total assets), and large credit unions (assets of at least €100m).

We continue to supervise credit unions in a manner that is proportionate and appropriate to the nature, scale, and complexity of individual credit unions. Credit union size combined with risk profile are the drivers of the frequency of inspections (including mandatory meetings), enabling us to proportionately differentiate between credit unions of different size and risk profile. The supervision of the largest credit unions involves regular on-site inspections. The deployment of this proportionate approach means that those credit unions which could have greater impact from a risk perspective will experience a greater degree of engagement, scrutiny and challenge from supervision teams.

Our desk-based supervisory approach extends to credit unions with total assets of up to €100m. Desk-based supervisory engagements involve reviews of credit union-specific documentation and supervisory intelligence, supported by individual and sectoral analytics, peer analysis and thematic reviews, as appropriate.

The application of a proportionate risk-based approach to supervision means that some risk areas in certain credit unions are inspected more intensively than others.⁴ Supervision teams scope the inspection based upon the risk profile of the credit union, informed by risk indicators and previously identified risk issues. This approach has an impact on the supervisory findings, as

² Section 84 of the Credit Union Act 1997.

³ Credit Union Managers' Association Spring Conference - [Registrar of Credit Unions address](#).

⁴ Credit unions that are subject to prudential supervision through our intervention and restructuring framework do not form part of the findings within the Supervisory Commentary. These credit unions are subject to a modified supervisory approach, which is tailored to reflect the challenges facing these credit unions.

increased risk vulnerabilities may be identified in those areas that are reviewed with greater intensity by supervision teams.

Similarly, it is important to note that the absence of such risk issues in a particular asset classification may not indicate that a particular issue is not present in that asset classification, rather it may not have been identified as part of our supervisory engagement. As a result, we recommend credit unions to focus on findings in relation to their own asset classification, but to also consider the findings across all asset classifications.

Presentation of Findings

This Supervisory Commentary is based on 621 individual risk issues, identified across seven risk categories of the PRISM framework during supervisory engagements by RCU. These risk issues form the basis for 103 individual RMPs issued to credit unions between January and October 2018 following supervisory engagements.

The remaining sections of this PRISM Supervisory Commentary are structured as follows:

- Section 4 provides a high level overview of the PRISM risk assessment findings.
- Sections 5 - 9 contains subsections on each of the risk areas. Each subsection outlines our overall supervisory expectations and key findings for that risk area, together with detailed findings (where applicable) identified as part of our supervisory engagements with credit unions across three asset classifications:
 - credit unions with assets of at least €100 million;
 - credit unions with assets of at least €40 million and less than €100 million; and
 - credit unions with assets less than €40 million.

Within each section, the supervisory findings are accompanied by supervisory expectations related to the risks identified in each category of risk. While these reflect our expectations for credit unions across the three asset classifications, they should have relevance for all credit unions.

Appendix 1 sets out examples of successful remediation of risks by credit unions, which supervision teams have identified during the review period. The objective of providing these examples is to offer insight to credit unions as to our expectations when an RMP is put in place, and to highlight the positive impact that successful implementation of RMPs has had in individual credit unions.

4. Overview of PRISM Risk Assessment Findings

The analysis within the Supervisory Commentary is provided across three asset classifications of credit unions as follows:

- i. Classification 1 - assets of at least €100m;
- ii. Classification 2 - assets of at least €40m and less than €100m; and
- iii. Classification 3 – assets of less than €40m.

Table 1 below sets out the distribution of the risks issues across the asset classes.

Asset Classification	No. of Credit Unions	As % of total credit unions in this asset class ⁵	No. of risk issues identified in this asset class
≥€100m	41	77%	273
≥€40m<€100m	30	37%	160
< €40m	32	22%	188
Total	103		621

Table 1

Figure 1 below sets out the percentage of risk issues identified by risk category.

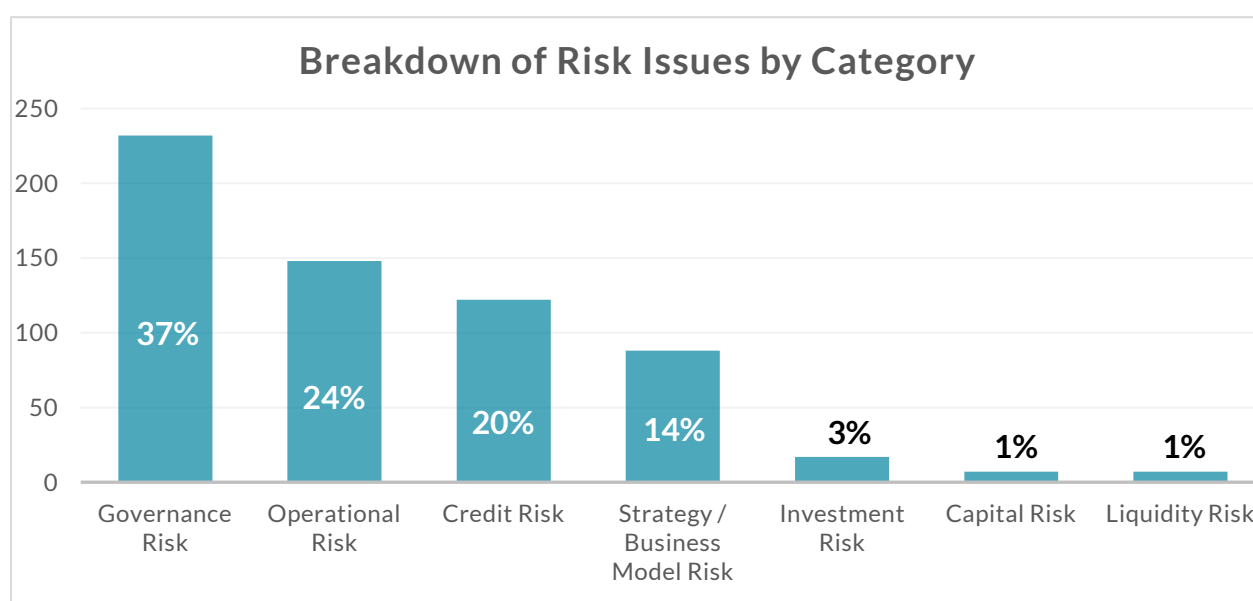


Figure 1

⁵ Figures from Prudential Returns as at 31st December 2018

PRISM Risk Assessment Findings

5. Governance Risk

Overall Supervisory Expectations

A credit union's core foundations are its governance, risk management and operational capabilities. The ultimate responsibility for the control, direction and management of the credit union vests with the board. Boards need to ensure they have adequate and appropriate resources and systems in place to meet their legislative and regulatory obligations. They must also ensure they have effective governance structures in place, including effective risk management, internal audit and compliance functions.

The Credit Union Act, 1997 (the 1997 Act), sets out comprehensive governance requirements for credit unions that are designed to provide a framework to promote strong governance standards with a particular focus at board and management level. Section 66A of the 1997 Act requires that a credit union's governance arrangements include a clear organisational structure with well-defined, transparent and consistent reporting lines.

Effective governance in credit unions is supported by strong leadership and oversight of key functions. Strengthening the key functions of governance and risk management, alongside operational capabilities, will enable credit unions to address the challenges they face. The risk management framework, in particular, should enable credit unions to identify, manage and mitigate risks to support a more sustainable business model. The current challenging operating environment for credit unions highlights the importance of having sound governance and risk management practices within a clearly articulated framework.

We outline specific supervisory expectations related to governance findings from our supervisory engagements in Section 5.4. While these reflect our supervisory expectations for credit unions across all three asset classifications, we expect that credit unions should take account of the nature, scale and complexity of their own business in considering how these expectations can inform their approach to identifying, managing and mitigating governance risk issues in their credit union.

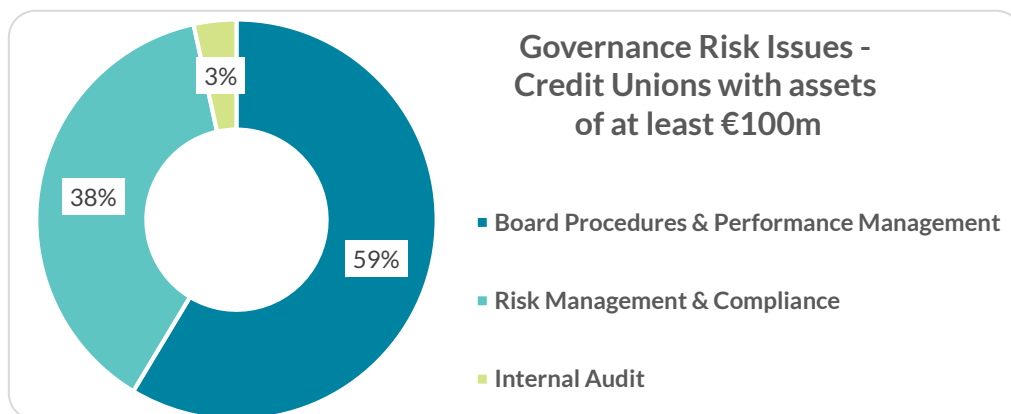
Overall Governance Risk Findings

Our findings in relation to governance evidence deficiencies related to board procedures and performance management, risk management and compliance and internal audit. We found evidence of a lack of board oversight and poor board engagement with these key functions, including an inadequate response by boards to findings and recommendations identified in risk, compliance and internal audit reports. We also noted issues in other cases with the quality of

reports being provided to boards, while in some cases failure to adequately resource these key functions was noted. We found evidence of inconsistencies and contradictions between stated risk appetites and the policies, procedures and practices of some credit unions, reflecting a failure to ensure the activities of the credit union align with its stated risk appetite. The board maintains ultimate responsibility for the level and type of risks that the credit union is willing to accept, in pursuit of its strategic objectives. The policies, procedures and practices of the credit union should reflect the board's stated risk appetite.

5.1 Governance Risk – Credit Unions with assets of at least €100m

Of the 41 credit unions with assets of at least €100m that received an RMP during the review period, 39 were found to have governance risk issues. The key governance risk issues identified in this classification of credit unions related to board procedures and performance management, risk management and compliance and internal audit. The findings reflect more embedded governance frameworks in these credit unions with the largest proportion of issues identified relating to board procedures and performance management.



Board Procedures and Performance Management

Following our supervisory engagements with credit unions with assets of at least €100m, we found governance risk issues related to board procedures and performance management in 36 credit unions across the sample of 41. Common risk issues identified in the area of board procedures and performance management included the following:

- *Failure by the board to formally respond to issues raised by the risk management, compliance and internal audit functions;*
- *Failure by the board to formally review the performance of the risk management and compliance functions, as required; and*
- *Key-person risk/succession planning weaknesses.*

Risk Management and Compliance

We found governance risk issues related to risk management and compliance in 26 credit unions across the sample of 41. Common risk management and compliance risk issues identified in these credit unions included the following:

- *Risk management and compliance reports which were insufficient in terms of detail, failing to highlight key risks, mitigation plans or to identify responsible parties and required actions;*
- *Inconsistencies between the documented risk appetite of the credit union and the related policies which implement the risk appetite;*
- *The absence of a formal process for addressing findings and recommendations identified in risk reports and compliance reports; and*
- *Failure to implement an effective risk management/compliance function within the credit union.*

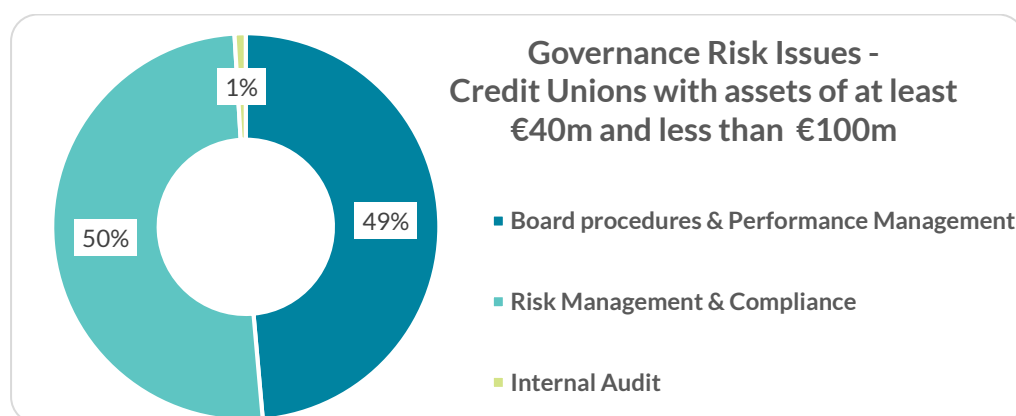
Internal Audit

Following our supervisory engagements in credit unions with assets of at least €100m, we found governance risk issues related to internal audit in 5 credit unions across the sample of 41. Common internal audit risk issues identified included the following:

- *Shortcomings in the internal audit reports being presented to boards, failing to reflect the guidance outlined in the Credit Union Handbook;*
- *Failure of the board to review at least annually the performance of the internal audit function; and*
- *The absence of a formal process for addressing findings and recommendations identified in internal audit reports.*

5.2 Governance Risk – Credit Unions with assets of at least €40m and less than €100m

Of the 30 credit unions with assets of at least €40m and less than €100m that received an RMP during the review period, 24 were found to have governance risk issues. The key governance risk issues identified here were in the same areas as those identified in credit unions with assets of at least €100m. However, the distribution of these issues differs somewhat with a higher proportion of issues identified in relation to risk management and compliance, reflecting issues around the level of embeddedness and the effectiveness of these functions in some credit unions in this classification.



Board Procedures and Performance Management

Governance risk issues relating to board procedures and performance management were identified in 22 credit unions across the sample of 30. Common risk issues identified in the area of board procedures and performance management included the following:

- *Failure by the board to formally respond to issues raised by the risk management, compliance and internal audit functions; and*
- *Evidence of staff and management frameworks in these credit unions being insufficiently resourced or poorly structured.*

While the area of board procedures and performance management represents a marginally smaller percentage of issues identified in these credit unions than in larger credit unions, it is notable that one of the more prevalent risks identified in this classification is that the staff and management frameworks are insufficiently resourced or poorly structured.

Risk Management and Compliance

We found governance risk issues related to risk management and compliance in 21 credit unions across the sample of 30. Common risk issues identified in this area included the following:

- *Failure to implement an effective risk management/compliance function within the credit union; and*
- *Weaknesses related to risk management and compliance reports. Reports presented lacked detail and failed to highlight key risks for the credit union.*

As noted above, under board procedures and performance management, supervision teams identified failures by the board to respond to the issues raised within these reports.

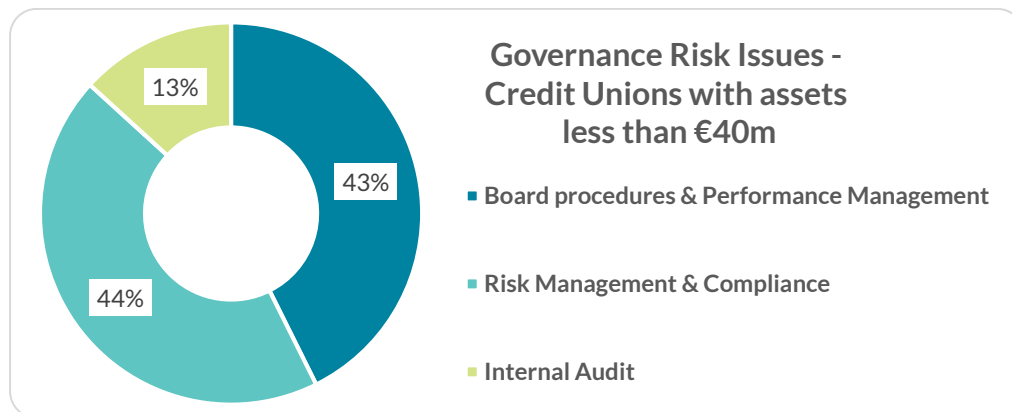
Internal Audit

Following our supervisory engagements in credit unions in this classification, we found governance risk issues related to internal audit in 1 credit union across the sample of 30. A key risk issue identified in this area was the following:

- *Shortcomings in the internal audit reports being presented to boards, failing to reflect the guidance outlined in the Credit Union Handbook.*

5.3 Governance Risk – Credit Unions with assets less than €40m

Of the 32 credit unions with assets less than €40m that received an RMP during the review period, 22 were found to have governance risk issues. As in the classifications above, key risk issues identified are in the following areas: board procedures and performance management, risk management and compliance, and internal audit. As with the credit unions in the assets of at least €40m and less than €100m classification, the highest proportion of issues identified relate to risk management and compliance, again reflecting issues with the level of embeddedness and the effectiveness of these functions in some credit unions in this classification.



Board Procedures and Performance Management

Following our supervisory engagements in these credit unions, we found governance risk issues related to board procedures and performance management in 16 credit unions across the sample of 32. Common risk issues identified in the area of board procedures and performance management included the following:

- *Failure by the board to formally respond to issues raised by the risk management, compliance and internal audit functions; and*
- *Weaknesses in relation to minute taking, with failures to reflect decisions taken at meetings.*

It is notable that one of the weaknesses identified in these credit unions related to minute taking. Ascertaining the quality of challenge and decision making forms a key part of our supervisory

engagements with credit unions, and we can only evidence this where it is noted in minutes of meetings held. Equally, the minutes of each meeting represent the credit unions own record of decisions taken and represent an important aspect of record management in respect of meetings held.

Risk Management and Compliance

We found governance risk issues related to risk management and compliance in 18 credit unions across the sample of 32. Common risk issues identified included the following:

- *A significant number of credit unions failing to implement an effective risk management/compliance function;*
- *A number of instances of credit unions failing to undertake adequate risk assessment related to strategic proposals or objectives, indicative of inadequate oversight of strategy; and*
- *Continued weaknesses related to risk management and compliance reports, alongside the failure by the board to respond to issues raised, as highlighted above.*

One of the common findings identified during supervisory engagements was a failing to undertake adequate risk assessment related to strategic proposals or stated objectives. This is a common issue where risk management is not properly implemented within the credit union and is not informing the decision making process for directors and management.

Internal Audit

We found governance risk issues related to internal audit in 9 credit union across the sample of 32. A common risk issue identified in this area was the following:

- *Shortcomings in the internal audit reports being presented to boards, failing to reflect the guidance outlined in the Credit Union Handbook.*

It is notable that supervisory teams have identified a higher proportion of issues within these credit unions related to internal audit than in those credit unions with assets of at least €100 million.

5.4 Governance Risk – Supervisory Expectations

Board Procedures & Performance Management

- Directors should demonstrate a risk-based mind-set, as evidenced by an understanding of the ongoing issues raised by each of the risk management, compliance and internal audit functions, as well as an appreciation of material business risks and how those risks are being managed. Evidence of this understanding and awareness should be demonstrated by meaningful board consideration and responses to risk management, compliance and internal audit reports.
- Credit unions should have a detailed succession plan for the board and management team to ensure that the credit union maintains an appropriate level and mix of skills and competencies at non-executive and executive level in order to support the credit union's strategic goals. The succession plan should include arrangements to avoid over-reliance on individuals by providing mechanisms for delegation of responsibility within the credit union, including revolving roles where appropriate.
- Adequate segregation of duties should be in place across the credit union. The clear distinction of roles is fundamental to the delivery of effective governance. Adequate resourcing is important in ensuring adequate separation of duties taking account of nature, scale and complexity of the credit union.
- Minutes of meetings must reflect decisions taken and provide sufficient detail to identify the nature and extent of discussions held as part of the decision making process.

Risk Management and Compliance

- Well-developed frameworks in place for both the risk management and compliance functions. In each case, the established framework should be commensurate with the nature, scale and complexity of the credit union.
- Risk and compliance reports should have sufficient detail to enable boards to gain a comprehensive understanding of issues identified by these key support functions. Where significant issues are identified by these functions, these issues should be brought to the attention of the board and CEO immediately. The board should ensure that they adequately consider findings in reports presented to them and take appropriate actions where necessary.
- Boards need to ensure that the risk management and compliance functions are appropriately resourced and supported in order to be able to carry out their functions having regard to the nature, scale, complexity and risk profile of the credit union.
- In identifying or implementing strategic objectives, the expectation is that credit unions maintain a risk-focussed approach, ensuring an appropriate and detailed assessment of the key financial and non-financial resources needed to support such objectives.

Internal Audit

- Credit unions are expected to have a well-resourced, skilled and experienced internal audit function in place, reflective of the credit union's nature, scale and complexity. Reports from this function should be of the required standard to add value and aid decision-making in the credit union.
- At a minimum, quarterly reports should be provided to the board which provide a comprehensive objective assessment of the effectiveness of the credit union's risk management framework and internal control and governance processes. Reports should be clear, concise and constructive, in order to assist boards in understanding the issues identified.
- Credit union boards should be cognisant of the issues identified by internal audit. In this regard, we would expect to see evidence of discussion and challenge by the board in relation to issues raised by internal audit. Quality engagement between boards and the internal audit function should ensure issues identified are clearly understood and remediated in a timely manner. Boards should give due consideration to recommendations made by internal audit in their reports and should ensure that there is appropriate follow-up on remediation where weaknesses are identified.
- Boards are required to review the effectiveness of the internal audit function on an annual basis and any shortcomings or deficiencies should be highlighted and addressed as part of this review. This will help to ensure that the internal audit function can add value and aid decision-making in the credit union, given that it represents a key support to boards.
- Credit unions need to ensure that the internal audit function, which is an integral part of the three lines of defence, provides objective assurance to the board on the effectiveness of the credit union's risk management, internal control and governance processes. Where issues are identified, internal audit should make recommendations to the board on improving these with appropriate follow-up to ensure recommendations have been implemented effectively.

6. Operational Risk

Overall Supervisory Expectations

The operational risk profile of many credit unions is increasing due to growing complexity of risk factors, including those driven by the types and number of systems in use, as well as expanding branch networks across enlarged credit unions. Our expectation for larger credit unions is for a high level of operational risk awareness with the capability to identify and remediate risks in a timely manner.

The Central Bank expects that the boards and management of credit unions fully recognise their responsibilities in relation to operational risk management and appropriately prioritise it within their risk management framework. It is important for a credit union to develop a sound appreciation for material operational risks arising from significant business activities and how these risks are interrelated. Risks should be identified and their management and mitigation addressed in policies, procedures and processes.

In January 2018, the Central Bank published the findings of an *IT Thematic Review in Credit Unions*⁶, based upon inspections of a number of credit unions with regard to their management of IT Outsourcing, Business Continuity Management and IT Security. The report outlined a number of deficiencies and weaknesses in credit union's operational risk frameworks and our general expectation in each area.

We outline specific supervisory expectations related to operational risk findings from our supervisory engagements in Section 6.4. While these reflect our supervisory expectations for credit unions across all three asset classifications, we expect that credit unions should take account of the nature, scale and complexity of their own business in considering how these expectations can inform their approach to identifying, managing and mitigating operational risk issues in their credit union.

Overall Operational Risk Findings

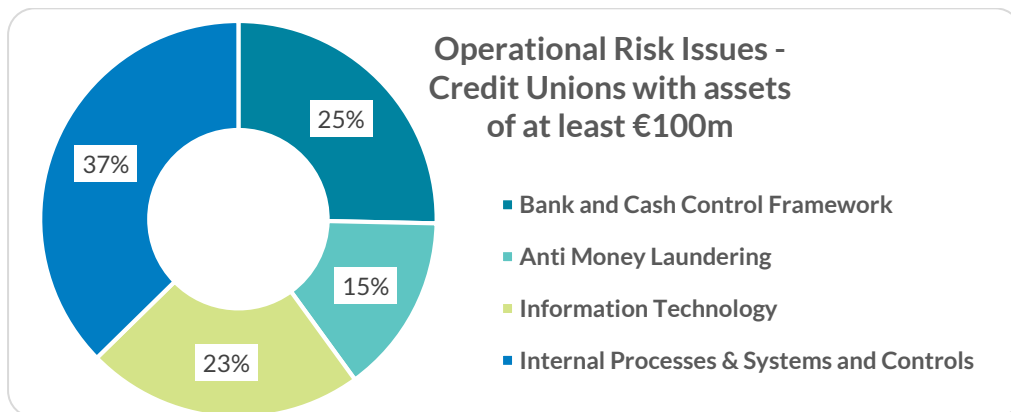
Operational risk failures can have significant reputational and financial consequences for credit unions. In this regard, it is important that operational risks are identified early-on, thereby enabling comprehensive assessment and mitigation. As part of our supervisory engagements during the review period, we found failings in internal controls including segregation of duties. We also noted deficiencies in systems of control related to bank and cash management. Weaknesses in operational procedures related to anti-money laundering remain and continue to be identified during supervisory engagements, with inadequate customer due diligence

⁶ <https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/credit-unions/communications/reports/it-risk-in-credit-unions-thematic-review-findings.pdf>

performed, leading to risk of non-compliance with the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010, as amended.

6.1 Operational Risk – Credit Unions with assets of at least €100m

Of the 41 credit unions with assets of at least €100m that received an RMP during the review period, 29 were found to have operational risk issues. The key operational risk issues identified related to internal processes/systems and controls, bank and cash control framework, anti-money laundering (AML) and information technology.



Internal Processes/Systems and Controls

We found operational risk issues related to internal processes/systems and controls in 19 credit unions across the sample of 41. Common risk issues identified in this area included the following:

- *Weaknesses in segregation of duties within the credit union;*
- *Examples of business continuity plans not being reviewed or updated following testing and failure to reflect any adverse findings or shortcomings following such testing; and*
- *Weaknesses around the process for the reactivation of dormant members' accounts.*

Bank and Cash Control Framework

We found operational risk issues related to the bank and cash control framework in 15 credit unions across the sample of 41. The findings related to bank and cash control frameworks in credit unions with assets of at least €100m give rise to key concerns, in particular in respect of basic control measures surrounding a high-risk area of operations. Common risk issues identified in this area included the following:

- *Weaknesses in the documented procedures in place for bank and cash reconciliations within the credit union; and*

- *Lack of appropriate processes and controls regarding the physical movement of cash between sub-offices, giving rise to operational risk concerns.*

Anti-Money Laundering/Counter Terrorist Financing (AML/CTF)

We found operational risk issues related to anti-money laundering in 11 credit unions across the sample of 41. Common risk issues identified in this area included the following:

- *Weaknesses arising from incomplete customer due diligence documentation; and*
- *Weaknesses related to juvenile accounts and the AML controls attaching to these accounts.*

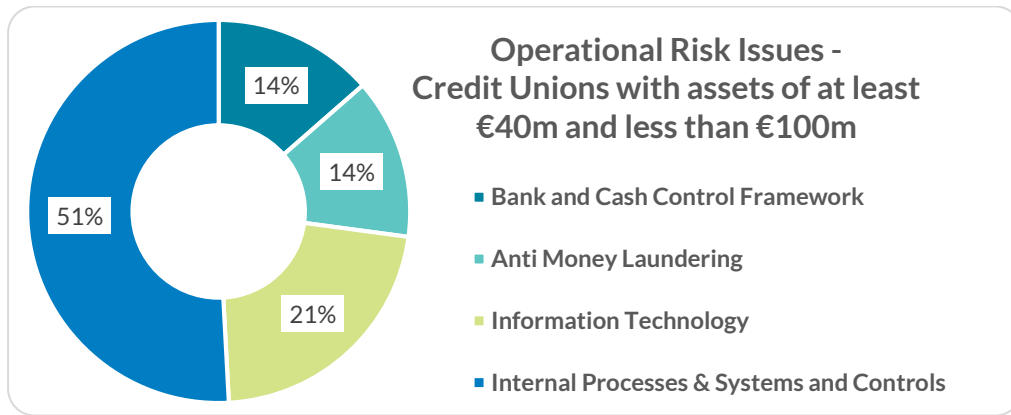
Information Technology

We found operational risk issues related to IT in 10 credit unions across the sample of 41. Common risk issues identified in this area included the following:

- *Excessive authorisation and/or access levels allocated to staff members on systems;*
- *Failure by credit unions to maintain an IT asset register; and*
- *Lack of an appropriately resourced IT function.*

6.2 Operational Risk – Credit Unions with assets of at least €40m and less than €100m

Of the 30 credit unions that received an RMP in this classification during the review period, 17 were found to have operational risk issues across similar areas as those credit unions with assets of at least €100m. The significant proportion of issues relating to internal processes & systems and controls is notable in these credit unions suggesting that failures to embed risk management, compliance and internal audit frameworks may be impacting on the quality of internal processes and systems and controls.



Internal Processes/Systems and Controls

Following our supervisory engagements in these credit unions, we found operational risk issues related to internal processes/systems and controls in 18 credit unions across the sample of 30. Common risk issues identified in this area included the following:

- *Business continuity plans not being reviewed or updated following testing to reflect any adverse findings or shortcomings;*
- *Failure to review service level agreements (SLAs) for outsourced service providers to the credit union; and*
- *Weaknesses in segregation of duties within the credit union.*

It is notable that a higher proportion of issues identified for these credit unions relate to internal processes and systems and controls. This may be reflective of less well developed and embedded risk management, compliance and internal audit frameworks, which are not as effective at identifying issues and supporting enhancements to internal processes.

Information Technology

We found operational risk issues related to IT in 11 credit unions across the sample of 30. Common risk issues identified in this area included the following:

- *Failure to conduct an independent review of IT systems post-implementation of new systems including examples of significant changes to IT systems introduced as part of a merger process where no implementation review was conducted to assess adequacy;*
- *Failure by credit unions to have an external penetration test conducted; and*
- *Failure by credit unions to maintain an IT asset register.*

It is concerning to note that post-implementation reviews are not taking place in a number of credit unions inspected in this classification where they have adopted a new IT system, or been

involved in a transfer of engagements requiring integration of systems. Such reviews are important to identify and address any issues associated with the migration to a new IT system.

Bank and Cash Control Framework

Following our supervisory engagements in these credit unions, we found operational risk issues related to the bank and cash control framework in 7 credit unions across the sample of 30. A common risk issue identified in this area was the following:

- *Weaknesses in documented procedures for bank and cash reconciliations.*

Anti-Money Laundering/Counter Terrorist Financing

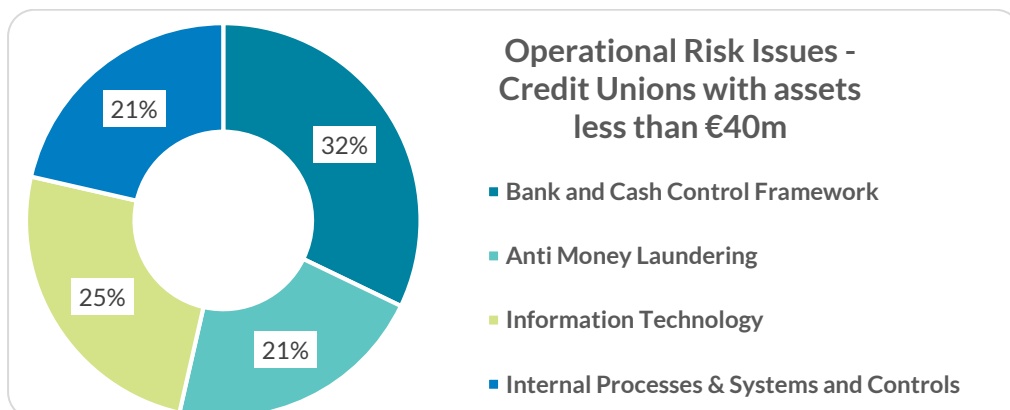
Following our supervisory engagements, we found operational risk issues related to anti-money laundering in 5 credit unions across the sample of 30. Common risk issues identified in this area included the following:

- *Overall weaknesses related to the AML control framework within the credit union; and*
- *Weaknesses arising from incomplete customer due diligence documentation.*

It is notable that our findings here identified weaknesses in the overall AML control framework in place within these credit unions. The expectation of the Central Bank is that the control framework in place is appropriate for the size and scale of the credit union, and that regular review and testing of the framework is conducted to ensure it is fit-for-purpose.

6.3 Operational Risk – Credit Unions with assets less than €40m

Of the 32 credit unions that received an RMP in this classification during the review period, 20 were found to have operational risk issues across the same areas as in the other asset classifications. However the findings were more evenly distributed across these areas for credit unions with assets less than €40m.



Internal Processes/Systems and Controls

Following our supervisory engagements in these credit unions, we found operational risk issues related to internal processes/systems and controls in 5 credit unions across the sample of 32. A common risk issue identified in this area included:

- *Widespread examples of business continuity plans not being reviewed or updated following testing and not reflecting any adverse findings or shortcomings.*

Failure to update business continuity plans following testing is a common risk issue for these credit unions. Ensuring continuity of service and minimising disruption to members must form a key goal of the review and testing process. This will only be achieved where findings and weaknesses are addressed as part of the follow-up process.

Information Technology

Following our supervisory engagements in credit unions in this classification, we found operational risk issues related to IT in 6 credit unions across the sample of 32. Common risk issues identified in this area included the following:

- *Evidence of inadequately resourced IT functions within this classification; and*
- *Evidence of excessive access/authorisation levels granted to staff on various IT systems, relative to their respective role and responsibilities.*

Bank and Cash Control Framework

Following our supervisory engagements in these credit unions, we found operational risk issues related to the bank and cash control framework in 9 credit unions across the sample of 32. A common risk issue identified in this area included the following:

- *Weaknesses in documented procedures for bank and cash reconciliations within the credit union.*

Anti-Money Laundering/Counter Terrorist Financing

Following our supervisory engagements in these credit unions, we found operational risk issues related to anti-money laundering in 5 credit unions across the sample of 32. Common risk issues identified in this area included the following:

- *Weaknesses arising from incomplete customer due diligence documentation;*
- *Weaknesses related to the overall AML control framework, including, but not limited to, the AML policy of the credit union; and*
- *Weaknesses related to the AML reporting framework in the credit union.*

6.4 Operational Risk – Supervisory Expectations

Internal Processes/Systems and Controls

- Systems of controls are in place and are appropriate to the nature, scale and complexity of the credit union. For credit unions with assets of at least €100m, we expect to find more sophisticated and well embedded systems and controls which are subject to regular testing, with any findings and remediation items acted upon in a timely and prioritised manner.

Bank and Cash Control Framework

- Appropriate oversight and supervision of cash management activities are in place. The credit union should have appropriate preventative and detective controls in place to minimise and mitigate the risks of loss through theft or misappropriation of credit union funds.
- Credit unions should regularly assess the adequacy of the systems and controls related to fundamental financial controls with a view to addressing and mitigating operational weaknesses as a priority matter.

Anti-Money Laundering/Counter Terrorist Financing

- Credit unions shall adopt policies, controls and procedures to prevent and detect the commission of money laundering and terrorist financing, as required by the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010, as amended. This should include, but is not limited to, policies, controls and procedures dealing with customer due diligence measures.

Information Technology

- Findings for credit unions with total assets less than €40m noted a common risk issue related to inadequately resourced IT function. Credit unions should have in place effective structures to manage IT related risks that are appropriate for the business model, size and technological complexity of the credit union, as well as the sensitivity and value of information and data assets held. As such, it is important that the IT function is adequately resourced with responsible and accountable individuals.

7. Credit Risk

Overall Supervisory Expectations

In order to ensure an appropriate lending framework is in place within the credit union, the board has ultimate responsibility to set the credit risk appetite, and understand and determine the nature and level of credit risk within the credit union.

In December 2018, Issue 4 of *'Financial Conditions of Credit Unions'* was published, which outlined sectoral analysis based upon credit union asset size and common bond type. New loans issued continued to increase over the period September 2014 to September 2018, from €1.7 billion to €2.5 billion. It is important that growth in new lending is in line with risk appetite and underpinned by robust underwriting practices and procedures.

Key to mitigating credit risk is the assessment of the member's ability to repay. This must be the primary consideration in the underwriting process and the credit union must manage and control lending to ensure the making of loans does not involve undue risk to members' savings. Appropriate procedures for assessing and measuring credit risk will provide relevant information for a credit union board to make judgements about the credit risk of its lending exposures and will facilitate the recognition of losses within the loan book as early as possible. It is important that the level of provisions held for loans is adequate. In April 2018, RCU published *'Provisioning Guidelines for Credit Unions'*, setting out the Central Bank's expectation on provisioning in credit unions. Credit unions should give due consideration to these guidelines when developing and implementing their provisioning frameworks and when assessing the adequacy of provisions.

We outline specific supervisory expectations related to credit risk findings from our supervisory engagements in Section 7.4. While these reflect our supervisory expectations for credit unions across all three asset classifications, we expect that credit unions should take account of the nature, scale and complexity of their own business in considering how these expectations can inform their approach to identifying, managing and mitigating credit risk issues in their credit union.

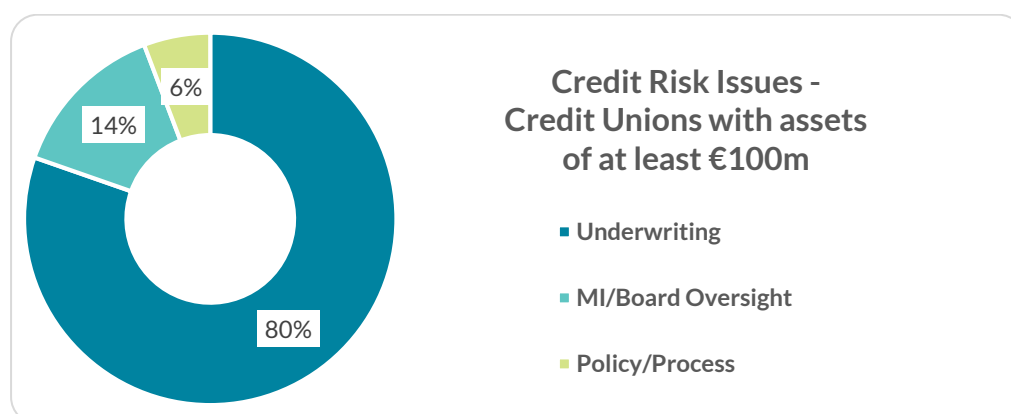
Overall Credit Risk Findings

While we see examples of improving credit frameworks in some cases, our findings in relation to credit risk continue to highlight some basic weaknesses in credit frameworks and underwriting practices in many credit unions. These include divergence in credit practices from stated credit policies, where stated policies are not reflected in day to day practice. We noted failure to assess member repayment capacity accurately, with income and expense items frequently overlooked

or omitted during the underwriting process. We also see evidence of inaccuracies in how the debt-to-income ratio is calculated as part of the underwriting process in a large number of cases.

7.1 Credit Risk – Credit Unions with assets of least €100m

Of the 41 credit unions with assets of at least €100m that received an RMP during the review period, 32 were found to have credit risk issues. The key credit risk issues identified are in the areas of underwriting, management information/oversight, and policy/process.



Underwriting

The highest proportion of credit risk issues identified for these credit unions related to underwriting. While this, to some extent, may result from the more intensive nature of supervisory engagements with this classification of credit unions, which includes loan sampling, the nature of the issues identified from the inspections is concerning. Following our supervisory engagements in these credit unions, we found credit risk issues related to underwriting in 31 credit unions across the sample of 41. Common risk issues identified included the following:

- *Widespread examples of issues, errors or miscalculation of debt-to-income ratios which are utilised as part of the loan assessment;*
- *Evidence of weak and/or the absence of a documented rationale on file to support lending decisions made by the responsible credit officer;*
- *Evidence of member's ability to repay was lacking or unable to be substantiated in numerous examples reviewed during loan file testing; and*
- *Examples of failure to successfully secure a first legal charge on house loans issued by the credit union.*

It is concerning to see such a significant proportion of credit risk issues related to underwriting in these larger credit unions, which include fundamental areas such as assessment of member's ability to repay and the absence of an adequate supporting rationale to support loan approvals.

Of significant concern is the failure by some credit unions to successfully secure a first legal charge on house loans issued. This is an area that was also highlighted as part of our thematic review findings related to house loans in January 2018⁷.

Management Information/Board Oversight

We found credit risk issues related to management information/board oversight in 19 credit unions across the sample of 41. Common risk issues identified in the area of management information/board oversight included the following:

- *Inconsistencies between stated risk appetite of the credit union and the credit policy/practices;*
- *Evidence of board oversight was absent in a number of examples reviewed. Awareness and oversight of the credit function within the credit union was not evident in these cases; and*
- *Examples of loans being misclassified were found as part of credit testing. The loan purpose in these cases was not consistent with the supporting documentation or rationale provided.*

Policy/Process

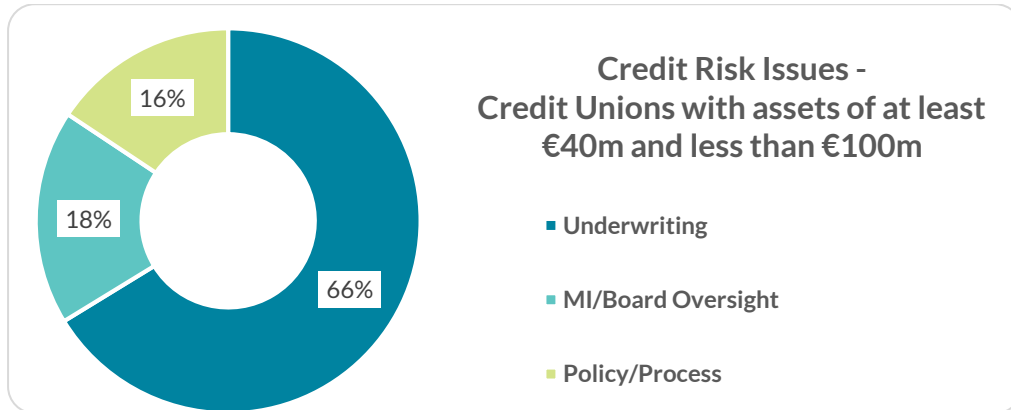
Following our supervisory engagements in credit unions in this classification, we found credit risk issues related to credit policy/processes in 8 credit unions across the sample of 41. Common risk issues identified in this area included the following:

- *A lack of written requests for reschedules retained on file; and*
- *Examples of deficiencies in credit policies which failed to reflect current legislative requirements and regulations.*

⁷ The Registry of Credit Unions published '[House Loans in Credit Unions – Thematic Review Findings](#)' in January 2018

7.2 Credit Risk – Credit Unions with assets of at least €40m and less than €100m

Of the 30 credit unions with assets of at least €40m and less than €100m that received an RMP during the review period, 18 were found to have credit risk issues across the same areas as credit unions with assets of at least €100m.



Underwriting

Following our supervisory engagements in these credit unions, we found credit risk issues related to underwriting in 16 credit unions across the sample of 30. Common risk issues identified in this area included the following:

- *Multiple examples of errors, miscalculations and omissions when calculating debt-to-income ratios for members, used as part of loan applications;*
- *Weaknesses and/or absence of documented rationale continues to present a common issue in these credit unions;*
- *Lack of evidence of the assessment of member's ability to repay as part of the underwriting process;*
and
- *Absence of accounts/verifiable income present for self-employed members used as part of the underwriting process.*

Of particular note for these credit unions is an absence of accounts for self-employed members used as part of the underwriting process.

Management Information/Board Oversight

Following our supervisory engagements in these credit unions, we found credit risk issues related to MI/board oversight in 12 credit unions across the sample of 30. Common risk issues identified in this area included the following:

- *Examples of misclassification of loan type evident in numerous files tested;*
- *Absence of board oversight of the credit function; and*
- *Failure to conduct quarterly loan book reviews as required, to determine adequacy of provisioning levels/monitoring of arrears.*

While our findings here reflect similar issues to those identified in larger credit unions, we specifically noted examples of failures to conduct quarterly loan book reviews as required.

Policy/Process

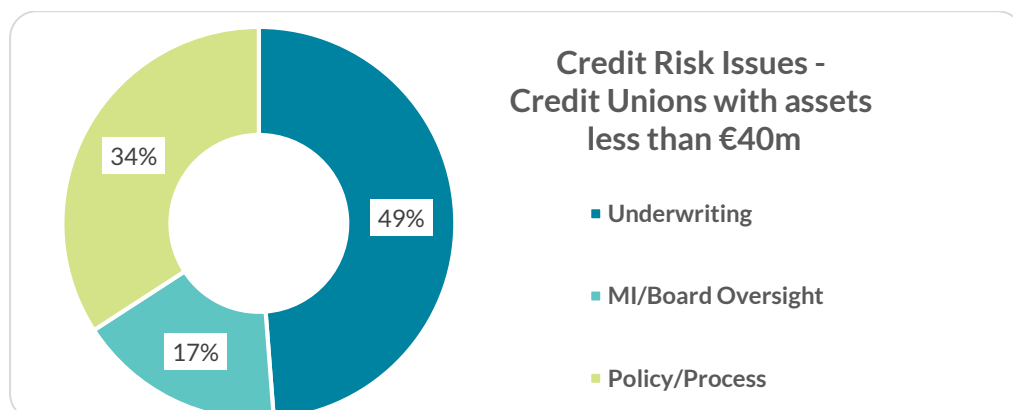
Following our supervisory engagements in these credit unions, we found credit risk issues related to credit policy/processes in 11 credit unions across the sample of 30. Common risk issues identified in this area included the following:

- *Examples of deficiencies in credit policies across this classification, with policies failing to reflect current regulation or legislative requirements.*
- *Absence of any framework in place for commercial lending was found in a number of cases; and*
- *Identified examples of top-up lending breaches within these credit unions in a small number of cases, where the credit union failed to adhere to its documented procedures.*

We noted a number of policy deficiencies as part of our findings for these credit unions and in particular we have identified instances where no framework exists for commercial lending where credit unions were undertaking this type of lending. The absence of an appropriate framework for such lending increases the risk of such loans not being properly underwritten, taking account of the risk profile and specific characteristics of this type of lending.

7.3 Credit Risk – Credit Unions with assets less than €40m

Of the 32 credit unions issued an RMP in this classification during the review period, 17 were found to have credit risk issues.



Underwriting

Following our supervisory engagements in these credit unions, we found credit risk issues related to underwriting in 7 credit unions across the sample of 32. Common risk issues identified in this area included the following:

- *Lack of evidence of the assessment of member's ability to repay as part of the underwriting process;*
- *Multiple examples of errors, miscalculations and omissions when calculating debt-to-income ratios for members, used as part of loan applications; and*
- *Weaknesses and/or absence of documented rationale for credit decisions.*

Management Information/Board Oversight

Following our supervisory engagements in these credit unions, we found credit risk issues related to MI/board oversight in 5 credit unions across the sample of 32. A common risk issue identified in this area was the following:

- *Examples of misclassification of loan type evident in numerous files tested.*

Policy/Process

Following our supervisory engagements in these credit unions, we found credit risk issues related to credit policy/processes in 11 credit unions across the sample of 32. Common risk issues identified in this area included the following:

- *Examples of deficiencies in credit policies, with policies failing to reflect current regulation or legislative requirements; and*
- *Identified examples of breaches of lending restrictions was detected in a small number of cases.*

A larger proportion of our credit risk findings for credit unions with assets less than €40m related to policy/process issues. It is concerning to note in our findings, examples of breaches of lending restrictions. This demonstrates a failure in the systems and controls in place to monitor these restrictions, as well as a lack of oversight and board awareness of the level of loans being issued.

7.4 Credit Risk – Supervisory Expectations

Underwriting

- All credit underwriting practices should be in line with policy, which in turn should be fit for purpose and reflect the risk appetite of the credit union. We expect to find all relevant documentation held on file and clear supporting rationale for the credit decision.
- Where a self-employed member is unable to provide the credit union with audited/certified accounts to verify his/her income, our expectation is that the applicant's accountant confirm details as to debtors, creditors, taxes etc. and confirm the member is solvent.

Management Information/Board Oversight

- Clear management and board oversight of the credit function must be evident including, but not limited to, review of policies and monitoring of the implementation of policies for credit risk. Where the credit union's policy allows for exceptions, and where it requires that such exceptions must be elevated to a higher level for sign off, we expect to see this procedure being followed in practice and that all exceptions are reported to the board on a monthly basis.

Policy/Process

- Credit unions must have well documented procedures in place and these procedures should be followed. We expect to see policies which are reflective of the credit union's risk appetite statement, as well as relevant legislative and regulatory requirements.
- Credit unions should regularly review provisions to determine their adequacy; quarterly loan book reviews should form part of the objective evidence of impairment when calculating provisions.
- At a minimum, our expectation is that credit unions require, as part of the underwriting process for a significant commercial loan, a comprehensive business plan and detailed financial projections (supported by evidence-based assumptions), appropriate for the scale and complexity of the loan.

8. Strategy/Business Model Risk

Overall Supervisory Expectations

The credit union regulatory framework requires the preparation of a strategic plan. Such a plan enables a credit union to articulate its future path and vision in serving its members. The plan sets out the goals and objectives, future financial performance and position of the credit union, reflective of its business model strategy, in line with its risk appetite and operational capabilities. It is evident that maintaining a clear strategic focus remains a challenge for some credit union boards. Identified weaknesses in core areas of governance and risk management raise concerns about the ability of some credit unions, including some large credit unions, to transition safely to a more complex business model. Meeting members' product and service expectations must be at the heart of such plans, on a basis that is within the credit union's capabilities.

Credit union boards and management are responsible for setting and overseeing their business strategy and risk appetite and should ensure that IT risk is considered in this context. For the vast majority of credit unions, IT is a core enabler of the business with most, if not all, of the critical business functions supported by IT. As such, it is important that the IT strategy is comprehensive and aligned with the overall business strategy so that it can deliver on objectives to support the current and future strategic direction of the credit union.

Through our engagement we continue to note inconsistencies with stated risk appetites and the level of risk taken in practice, through individual policies or more wide-ranging strategic initiatives.

We outline specific supervisory expectations related to strategy/business model risk findings from our supervisory engagements in Section 8.4. While these reflect our supervisory expectations for credit unions across all three asset classifications, we expect that credit unions should take account of the nature, scale and complexity of their own business in considering how these expectations can inform their approach to identifying, managing and mitigating strategy/business model risk issues in their credit union.

Overall Strategy/Business Model Risk Findings

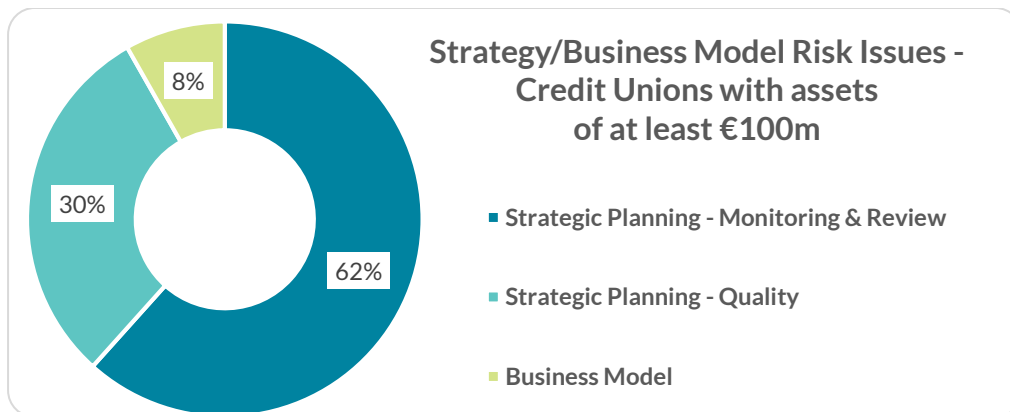
Some of the overall weaknesses identified during the review period related to strategy/business model risk including the absence of any stress testing or scenario analysis of the financial projections of the credit union. In addition, the reviews noted the absence of targets and/or criteria for assessing performance within the strategic plan. We frequently noted examples where financial projections, where presented, were not aligned to the stated strategic objectives of the credit union.

In some cases, we noted viability concerns where it was apparent that the credit union will not be able to generate a surplus in the short to medium term. In such instances we would expect to

see boards considering alternative strategies to serve members' future needs, including a transfer of engagements to a financially stronger credit union, capable of serving those needs.

8.1 Strategy/Business Model Risk – Credit Unions with assets of at least €100m

Of the 41 credit unions with assets of at least €100m that received an RMP during the review period, 28 were found to have strategy/business model risk issues. The key strategy/business model risk issues identified are in the areas of strategic planning – monitoring & review, strategic planning quality, and business model. Our findings evidence more developed strategic planning in some larger credit unions with the highest proportion of issues identified in relation to monitoring and review of strategic plans.



Strategic Planning – Monitoring & Review

Following our supervisory engagements in these larger credit unions, we found strategy /business model risk issues related to the monitoring and review of strategic plans in 26 credit unions across the sample of 41. Common risk issues identified in this area included the following:

- *Failure to include appropriate key performance indicators to adequately monitor the strategic objectives of the credit union against the plan; and*
- *Evidence of failure to update the strategic plan and /or incorporate the findings of any reviews of the plan.*

Strategic Planning – Quality

Following our supervisory engagements in these credit unions, we found strategy/business model risk issues related to quality of strategic plans in 20 credit unions across the sample of 41. Common risk issues identified in this area included the following:

- *Evidence of financial projections which were out of date and/or not reflective of the stated objectives of the credit union; and*

- *Examples of strategic plans lacking sufficient detail, including absence of timeframes, measurement criteria or owners of objectives.*

In order to improve the quality of the strategic planning process, there needs to be on-going dialogue between the board and management in respect of owners of objectives, level of detail and the appropriate measurement criteria required. This includes a shared understanding of the credit union's operating environment, associated risks and opportunities.

Business Model

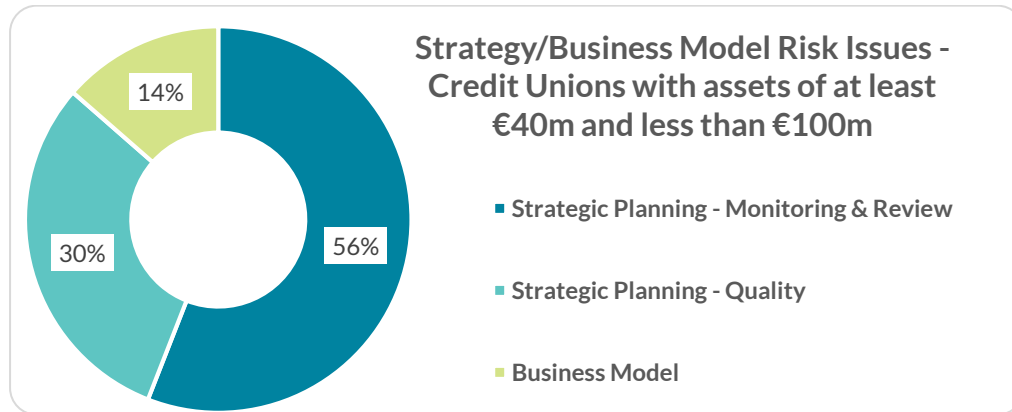
Following our supervisory engagements in these credit unions, we found strategy/business model risk issues related to the business model in 6 credit unions across the sample of 41. A common risk issue identified in this area was:

- *Examples of resourcing and organisational structural weaknesses. Failure to adequately resource key functions within the credit union.*

We noted that resourcing and organisational weaknesses were identified in a small number of larger credit unions in the context of business model risk.

8.2 Strategy/Business Model Risk – Credit Unions with assets of at least €40m and less than €100m

Of the 30 credit unions with assets of at least €40m and less than €100m issued an RMP during the review period, 17 were found to have strategy/business model risk issues.



Strategic Planning – Monitoring & Review

Following our supervisory engagements with these credit unions, we found strategy/business model risk issues related to the monitoring and review of strategic plans in 13 credit unions across the sample of 30. Common risk issues identified in this area included the following:

- Failure to include appropriate key performance indicators to adequately monitor the strategic objectives against the plan;
- Evidence of failure to update the strategic plan and/or incorporate the findings of any reviews of the plan during its stated term; and
- Limited or no evidence of challenge from the board to management, related to the monitoring and review of the strategic plan.

It is notable that our findings related to strategic risk for credit unions with assets of at least €40m and less than €100m demonstrate limited or no evidence of challenge from the board to management of the credit union on the review of the strategic plan. This risk was more common amongst these credit unions than in the larger credit unions inspected indicating less effective engagement from boards in their review of strategic plans in credit unions with assets of at least €40m and less than €100m.

Strategic Planning – Quality

Following our supervisory engagements in credit unions in this classification, we found strategy/business model risk issues related to the quality of strategic plans in 12 credit unions across the sample of 30. Common risk issues identified in this area included the following:

- Evidence of strategic plans which were insufficiently detailed, with an absence of owners or timeframes attaching to the various objectives;
- Evidence of financial projections which were out of date and/or not reflective of the stated objectives of the credit union; and
- Examples noted where there was failure to adequately stress test the financial projections or consider any scenario analysis as part of the strategic planning process.

We continue to see evidence of insufficiently detailed strategic plans, which lack owners of tasks/objectives, as well as an absence of suitable timeframes attaching to same.

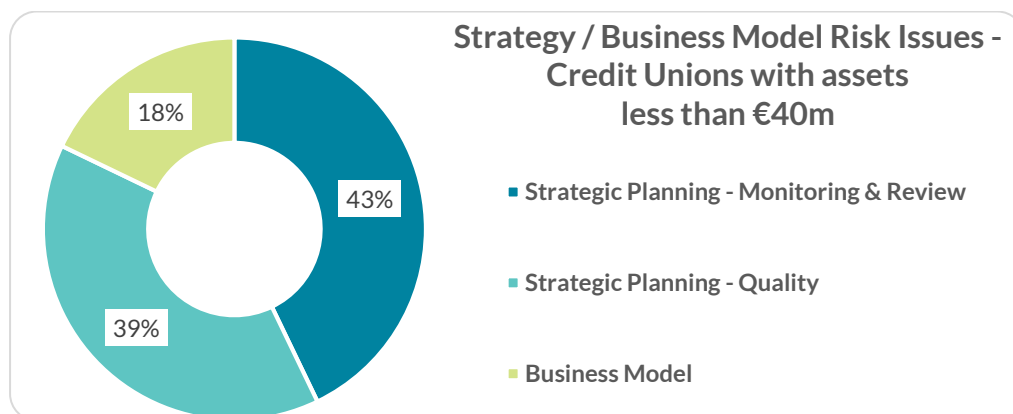
Business Model

Following our supervisory engagements in these credit unions, we found strategy/business model risk issues related to the business model in 8 credit unions across the sample of 30. Common risk issues identified in this area included the following:

- Evidence of significant viability concerns was noted in some cases across this sample of credit unions, representing challenges and constraints to the business model; and
- Examples of resourcing and organisational structural weaknesses evident. Failure to adequately resource key functions within the credit union.

8.3 Strategy/Business Model Risk – Credit Unions with assets less than €40m

Of the 32 credit unions that received an RMP in this classification during the review period, 23 were found to have strategy/business model risk issues. Our findings here were more heavily weighted towards the quality of strategic planning with lack of board engagement on strategic planning a specific concern in respect of these credit unions.



Strategic Planning – Monitoring & Review

Following our supervisory engagements in credit unions with assets less than €40m, we found strategy/business model risk issues related to the monitoring and review of strategic plans in 16

credit unions across the sample of 32. In these credit unions, it was notable that the monitoring of strategic plans was not always evident and represented a common risk issue.

Risk issues identified in this area included the following:

- *Failure to include appropriate key performance indicators to adequately monitor the strategic objectives against the plan;*
- *Evidence of failure to update the strategic plan and/or incorporate the findings of any reviews of the plan during its stated term; and*
- *Failure to regularly monitor strategic plans as part of our supervisory engagement findings in these credit unions, with strategy not featuring on board agendas, nor appearing as a discussion item within minutes of such meetings.*

Strategic Planning – Quality

Following our supervisory engagements in these credit unions, we found strategy/business model risk issues related to quality of strategic plans in 15 credit unions across the sample of 32. Common risk issues identified in this area included the following:

- *Evidence of strategic plans which were insufficiently detailed, with an absence of owners or timeframes attaching to the various objectives therein; and*
- *Evidence of financial projections which were out of date and/or not reflective of the stated objectives of the credit union.*

For these credit unions, our findings evidence issues with financial projections which in some cases were out of date, or not reflective of the objectives stated within the strategic plan.

Business Model

Following our supervisory engagements in these credit unions, we found strategy/business model risk issues related to the business model in 10 credit unions across the sample of 32. A common risk issue identified in this area was:

- *Evidence of significant viability concerns were noted in some cases across this sample of credit unions, representing challenges and constraints to the business model of the credit unions.*

The proportion of viability issues identified in these credit unions was higher than that of larger credit unions. The findings here evidence more specific business model issues facing some smaller credit unions.

8.4 Strategy/Business Model Risk – Supervisory Expectations

Strategic Planning – Monitoring and Review

- For credit unions with assets of at least €100m, we identified a greater proportion of risk issues related to the monitoring and review of strategic plans. Our expectation is that strategic management is viewed as an on-going activity by the board, not as a once-off task. In undertaking reviews and monitoring the strategic plan, the board needs to have a clear understanding of the credit union's performance, as well as its capabilities and capacity in order to inform such reviews.
- There should be demonstrable board oversight of strategy and associated implementation, including risk assessment and where required, effective risk mitigation arising from the implementation of same.

Strategic Planning – Quality

- The credit union's strategic plan must be feasible, realistic and achievable, grounded in the credit union's competence and capabilities and the needs of its members.
- Suitable financial risk assessment and stress testing should inform the projections which accompany the strategic plan and the projections must be supported with credible assumptions.
- Financial projections must be up-to-date, must align to the stated objectives and also reflect the expected costs and benefits of implementing the credit union's chosen strategy.

Business Model

- The board should have a strong understanding of the business model, proposed strategies and associated risks supported by an adequately resourced organisational structure in the credit union e.g. a well-resourced effective risk management function. This will ultimately assist the board in assessing the risks the credit union is taking, its vulnerabilities, and its capacity to identify risks and threats to the business model.
- Where viability concerns are present in the short to medium term, the expectation is that credit unions should formulate contingency strategies to ensure service continuity for members, including potential transfers of engagement.
- Furthermore, where viability is a serious concern, supervision teams challenge credit unions on how they intend to provide service continuity and on their contingency resolution planning arrangements.

9. Capital, Market and Liquidity Risk

Overall Supervisory Expectations

Capital

Adequate reserves are necessary to support a credit union's operations, provide a base for future growth and protect against the risk of unforeseen losses. Credit unions need to maintain sufficient reserves to ensure future sustainability and to protect members' savings. The regulatory reserve requirement sets out the minimum reserve requirement for credit unions. However, credit unions are expected to operate with a level of reserves above the regulatory reserve minimum requirement. It is for the board of directors of each credit union to decide on the amount of reserves to hold in excess of this minimum requirement having taken prudent account of the scale and complexity of the credit union's business, its risk profile and prevailing market conditions.

Market and Liquidity

In February 2018, the Central Bank announced changes to the investment regulations for credit unions.⁸ Three new investment classes were introduced, accompanied by the introduction of specified credit quality, maturity and concentration limits. The new investment classes introduced included bonds issued by supranational entities, corporate bonds and investments in Tier 3 Approved Housing Bodies (AHBs). Where credit unions seek to diversify their investments, our expectation is that the board fully understands the risks associated with such investments. Credit union boards must ensure that investment choices are taken in line with their risk appetite bearing in mind the regulatory obligation under the credit union investment framework not to expose member funds to undue risk.

In relation to market and liquidity risk, our primary expectation remains that a credit union manages its investments to ensure that those investments do not, taking account of the nature, scale, complexity and risk profile of the credit union, involve undue risk to members' savings and, in this regard, before making an investment the board is required to assess the potential impact on the credit union, including the impact on its liquidity and financial position.

Overall Risk Findings

The risk issues identified in relation to capital, market and liquidity risk represented a small proportion of findings in the sample of credit unions subject to review during the period.

⁸ Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (S.I. No. 1/2016)

With regard to market and liquidity risk, we noted examples of failure to include authorisation limits within the credit union's investment policy, representing an absence of a key control in the mitigation of risk of unauthorised decision-making in this area.

We also noted examples of failure to reflect the changes made to the Investment Framework in 2018 within the policies of the credit union.

Appendix 1 – Effective Implementation of Risk Mitigation Programmes

Risk Mitigation Programme – Governance Risk

Governance risk issues were identified by the supervision team during a supervisory engagement. The risk issue related to the structure and operation of the management team in the credit union. In this instance, the management team were fulfilling roles and responsibilities outside of their specified duties which impacted on their capacity to effectively perform their primary roles. This further negatively impacted on the management team's ability to deliver on the credit unions strategic goals and objectives.

Examples of issues noted by the supervision team included:

- The CEO had responsibility for multiple roles, which impacted on the capacity of the CEO to focus on strategic matter and fulfil the role of CEO;
- The risk and compliance officer (one individual) was involved in nomination committee activities and operational matters such as loan approvals; and
- The SWOT analysis contained in the Strategic Plan noted 'weaknesses' related to an 'Overdependence on individual resources at management team level' and 'Gaps in capability below management team'.

The credit union actively engaged with and fully implemented the RMP issued by the Central Bank, which included a requirement to undertake an organisational review, with the assistance of external expertise, of the management team and staffing structures.

The organisational review focussed on the appropriateness of current roles and responsibilities within the credit union and then devised a plan, which included a series of time-bound recommendations to remediate issues identified. These recommendations were adopted by the credit union and have been embedded into the governance framework. The RMP and associated organisational review has resulted in notable improvements in the structure and operational effectiveness of the management team within this credit union.

In a follow up inspection, carried out one year after issuing the RMP, significant improvements in the structure and operational effectiveness of the management team were noted. Members of the management team had clearly defined roles and responsibilities which, in particular, has allowed the CEO to focus on driving and implementing strategy. Further improvements in the areas of risk management, compliance and finance were also evident due to structural changes within these roles following the review.

Risk Mitigation Programme – Governance Risk

During one of our supervisory engagements, supervisors identified significant deficiencies within a credit union's risk management and compliance functions. In this instance, both functions were not operating effectively due to insufficient resources being allocated to them.

Deficiencies identified included insufficiently detailed risk management and compliance reports being provided to the board, the risk register not being kept up to date, the risk management plan being retained in draft format and limited testing being conducted by the risk management and compliance officers. The RMP issued to the credit union outlined that the board must undertake a review of both functions to ensure that it had the required resources to operate effectively and to comply with the relevant legislative and regulatory requirements and the guidance provided in the Credit Union Handbook.

When the RMP was issued, the credit union actively engaged with the Central Bank and displayed a willingness to make the necessary improvements to both functions, in a timely manner. The board immediately undertook a gap analysis of both functions to ascertain the current resourcing in place versus that required in order to satisfy the RMP outcomes sought. As a result of its review the Board doubled the time allocated to both functions. The board subsequently confirmed that the issues identified in the RMP had been remediated.

The RMP also required the credit union's internal auditor to undertake a comprehensive review of the effectiveness of the risk management function (as required under Section 76K (1) of the 1997 Act). The internal auditor subsequently validated that the issues raised in the RMP were addressed and that risk management and compliance training had been provided to credit union officers.

The supervisors highlighted the key risks in the RMP with the risk management and compliance functions and the Board undertook the required actions, which resulted in significant improvements to the effectiveness of both functions. The key governance functions of risk management and compliance significantly improved and the RMP appears to have also strengthened the board's appreciation for the importance of these functions and the support they provide the board in identifying, managing and mitigating key risks and compliance issues.

T: +353 (0)1 224 6000
E: RCU@centralbank.ie
www.centralbank.ie



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem