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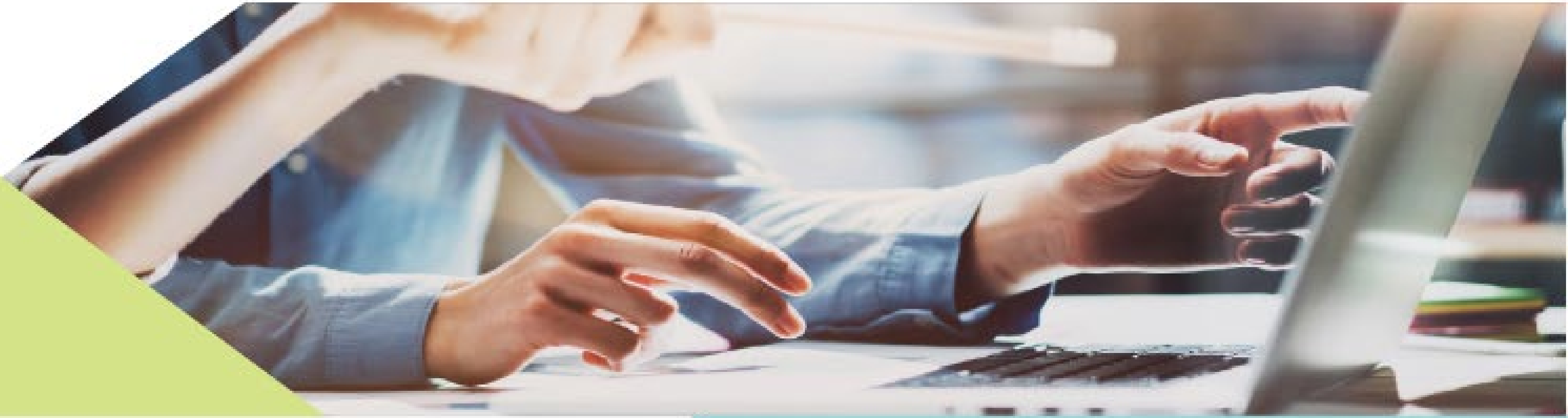

Credit Union 2022 Financial Year End

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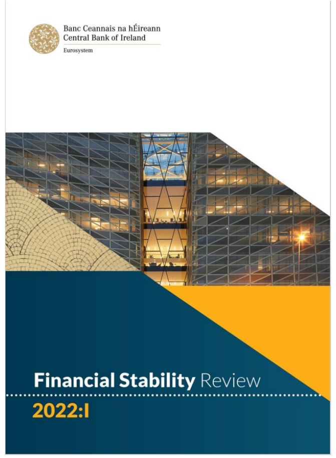
Contents

Context

Challenged Economic Environment and Uncertain Outlook

Macro-Financial Environment



- The economic environment for credit unions remains challenging and the outlook uncertain.
- Consumer and business confidence has reduced due to the continued effects of the ongoing war in Ukraine, high inflation and heightened uncertainty.
- High inflation reducing disposable incomes of households.
- Consumer spending projected to grow at slower rate than previously forecast.
- Uncertainty in the medium term outlook remains high.
- Pandemic related concerns replaced by lower global growth expectations, significant price pressures & tightened financial conditions.
- Domestically, indications of emerging cyclical pressures in certain sectors.
- All of these factors exacerbate the risks and challenges for credit unions, ***heightening the well-documented sustainability challenges faced by many individual credit unions***.

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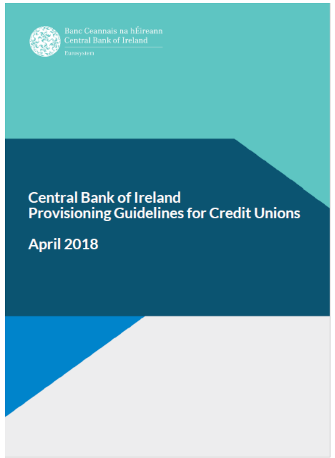
1. Impairment Reviews – Loan Provisioning

"detailed assessments of loan books are rigorous, with loan losses prudently provided for with an overarching objective of ensuring the level of distress is not underestimated"

- Provisioning guidelines issued in April 2018 should continue to inform the credit union's approach to assessing the level of required loan loss provisions on an on-going basis.
- Credit unions should consider how circumstances arising from the ***evolving economic situation*** may affect the likelihood of ***loss events*** occurring in their loan portfolios and apply provisions in a ***prudent* manner.**
- ***Financial Reporting Standard 102 (FRS 102)*** – requires an '*incurred loss*' approach to calculation of bad debt provisions on loans and that all loans are reviewed for ***objective evidence of impairment.***



1. Impairment Reviews (continued) – Fixed Assets & Investments

Section 110 of the 1997 Act requires that the amount of any item (fixed assets / investments) in the accounts shall be determined on a prudent basis.

- Fixed Assets – Where a ***value in use*** approach is adopted for the valuation of a credit union premises, the directors should consider the appropriateness of the underlying assumptions used in deriving the expected cash flows to ensure they are reasonable and supportable particularly in the current economic environment.
- Investments – The accounting policy adopted by the board of directors of a credit union for the valuation of investments should comply with the relevant sections of the Credit Union Act, 1997.
- ***Section 110 of the 1997 Act*** requires that the amount of any item in the accounts shall be determined on ***a prudent basis*** and in particular that ***all liabilities and losses*** which have arisen, or are likely to arise in the financial year to which the accounts relate, or a previous financial year, ***shall be taken into account.***

2. Credit Union Pension Schemes

Section 108 of the 1997 Act requires that the accounting records of the credit union give a true and fair view of the state of affairs of the credit union and disclose the financial position of the credit union.

- Pension costs and connected disclosure issues have been highlighted by the Registry for some time.
- Deficit of the ILCU pension scheme has not raised sector stability concerns but affected credit unions will be financially impacted.
- Clear example of the importance of building and maintaining adequate reserve levels to protect against future unforeseen losses.
- Important that members receive full clarity and transparency in the annual financial statements.
- Credit Union expected to take a prudent approach to upfront recognition of financial impairments in 2022 and ensure compliance with relevant accounting standards including FRS 102.
- Boards should fully understand the implications of any new pension arrangements for their credit union including risk management considerations.

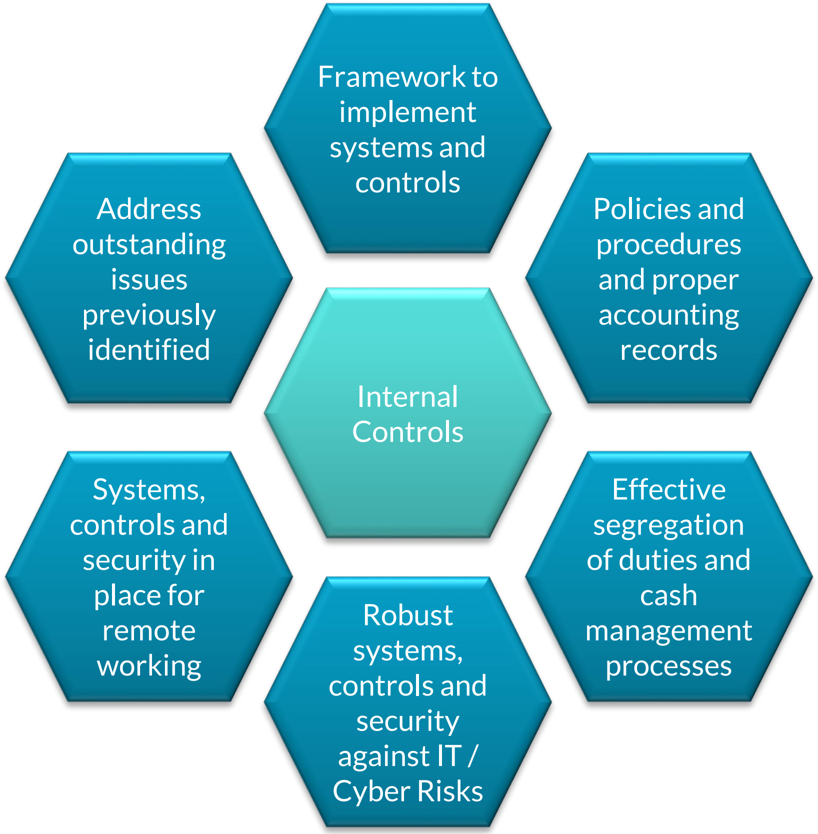
3. Credit Union Distributions and Prudent Reserve Management

"Maintaining and building adequate reserves remains key to ensuring financial stability and resilience"

- There continues to be ***elevated levels of risk and uncertainty*** regarding economic outlook with a challenging economic environment.
- Impacts of pandemic have been acutely felt by credit unions. Increases in the level of savings coupled with a significant decrease in loan demand have resulted in ***decline in the reserve positions of many credit unions***.
- Maintaining and building adequate reserves, including adequate operational risk reserves, remains key to ensuring credit union financial stability and resilience. We expect all credit unions to continue to take a ***prudent approach to distributions in the context of reserve management***.
- Any credit unions considering the potential for a proposed distribution are expected to ***contact their supervisor*** within RCU outlining the rationale for the proposed distribution taking account of liquidity and operational resilience positions and the ***need to demonstrate prudent forward-looking capital reserve management in the current environment***.
- Affiliated credit unions in receipt of SPS refund payments should continue to exercise prudence in reserve management and also account for these refunds in line with accounting standards.

4. Systems of Control & Cybersecurity

"Credit unions are reminded of their responsibilities for establishing an effective internal control framework and for monitoring the systems and controls on an ongoing basis."



- Year-end is an opportunity for each credit union to review its internal controls environment.
- Increased number of IT and cybersecurity incidents reported by organisations domestically and internationally.
- Credit unions need to be continuously vigilant regarding their ***IT systems vulnerabilities***, particularly from ***cyber risks*** and ensure on an ongoing basis that they have strong systems of controls in place relating to their IT framework.
- Given the potential adverse impacts arising, IT and cybersecurity risks remain a key focus for the Central Bank and should be an on-going priority for credit unions.
- Responsibility of each credit union to understand the range of risks it is exposed to and ensure that these are appropriately mitigated and managed.

5. Accrued Interest – Contingent Liability

"Important that credit unions ensure that appropriate recognition criteria and measurement bases are applied to contingent liabilities."

- 2021 Year-end letter reminded credit unions of the need to assess potential issues relating to accrued interest.
- Concerning that the 2021 year-end supervisory engagement identified credit unions which had not taken sufficiently evidenced based decisions.
- Further interaction from RCU with a cohort of relevant credit unions with correspondence issued last month.
- Expectation that all pertinent matters are considered in order for the financial accounts for September 2022 to reflect an accurate and up-to-date position.
- Affected members are expected to have been advised or are being advised of planned actions and reimbursements, as appropriate.
- Important that credit unions ensure that appropriate recognition criteria and measurement bases are applied to contingent liabilities and that sufficient information is disclosed to enable members to understand the underlying matter.

6. Draft Financial Statements

"Credit unions should focus on the timely preparation of the 2022 annual accounts and audit arrangements, so that the financial position is finalised and this can inform board and management decision making".

- Draft Financial Statements return to be submitted **via Portal** in advance of their finalisation.
- Supervisors may follow up directly with individual credit unions on any issues arising.
- Investment portfolio return due to be submitted on 28^{th} October 2022.
- Any questions or issues with any of the submissions please contact your supervisor.

Conclusion / Summary

- Credit unions, in preparing their 2022 accounts, should take account of all matters set out in the *2022 Financial Year-End Circular*.
- The boards of directors need to carefully consider the adequacy of loan provisions, other asset impairments and prudent reserve management in 2022, given the current uncertain economic outlook and significant related challenges.
- Maintaining and building adequate levels of reserve, including operational risk reserves, remains key to ensuring credit union financial stability and resilience.
- Credit unions should take a ***prudent, conservative approach to the 2022 year-end*** in terms of distributions, reserves management, provisions, impairment reviews, liquidity and overall resilience.
- Credit unions are ***to contact their supervisor within RCU where they are considering distributions*** setting out the rationale and how the proposal ***demonstrates prudent forward-looking capital reserve management in the current environment***.

"It is fundamentally important that a prudent approach is maintained to all aspects of a credit union's business, including lending, investments, liquidity and reserve management, to underpin the overall financial resilience of the credit union."

Appendix 1 – Central Bank Publications

Economic Publications

- SME credit conditions in the pandemic recovery
- Inflation and Mortgage Repayments: The Household Expenditure
- Climate Risks in the Financial System – An Overview of Channels Impact and Heterogeneity
- Quarterly Bulletin Q3 2022 | Central Bank of Ireland | Central Bank of Ireland
- Financial Stability Review 2022 : I (June 2022)