



International
Credit Union
Regulators'
Network

Central Bank of Ireland Peer Review Report

**Central Bank Performance of its
Regulatory Functions in Relation to
Credit Unions**

ICURN Credit Union Peer Review

July 2015

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1. Glossary

Acronyms & Abbreviations	
Academic and Professional Training Scheme	APTS
Annual General Meeting	AGM
Anti-Money Laundering/Countering the Financing of Terrorism	AML/CFT
Anti-Money Laundering Division	AML/D
Automated Teller Machine	ATM
Board Oversight Committee	BOC
Central Bank and Financial Services Authority of Ireland	CBFSAI
Central Bank of Ireland	Central Bank
Commission on Credit Unions	CCU
Consultation Paper	CP
Controlled Function	CF
Credit Union Advisory Committee	CUAC
Credit Union Development Association	CUDA
Credit Union Managers' Association	CUMA
Credit Union Restructuring Board	ReBo
Credit Union Self-Assessment Document	CUSAD
Customer Due Diligence	CDD
Deposit Guarantee Scheme	DGS
Deposit Protection Account	DPA
Electronic Funds Transfer	EFT
European System of Central Banks	ESCB
European Union	EU
Financial Action Task Force	FATF
Financial Emergency Measures in the Public Interest Acts 2009 and 2013	FEMPI Acts
Financial Reporting Council	FRC
Financial Reporting Standards	FRS
Full Risk Assessment	FRA
Generally Accepted Accounting Principles	GAAP
Incurred But Not Reported	IBNR
Information Technology	IT
International Accounting Standards	IAS
International Auditing and Assurance Standards Board	IAASB
International Credit Union Regulators' Network	ICURN
International Financial Reporting Standards	IFRS
International Monetary Fund	IMF
Intervention & Restructuring	I&R
Irish Auditing and Accounting Supervisory Authority	IAASA
Irish Financial Services Regulatory Authority	IFSRA
Irish League of Credit Unions	ILCU

Key Risk Indicator	KRI
Memorandum of Understanding	MOU
Money Laundering Reporting Officer	MLRO
Net Realizable Value	NRV
Personal Retirement Saving Accounts	PRSAs
Pre-Approval Controlled Function	PCF
Probability Risk and Impact System	PRISM
Prudential Capital Assessment Review	PCAR
Recognized Accountancy Bodies	RAB
Registry of Credit Unions/The Registry of Credit Unions	RCU
Regulatory Impact Analysis	RIA
Risk Evaluation Questionnaire	REQ
Risk Governance Panel	RGP
Risk Mitigation Programme	RMP
Savings Protection Scheme	SPS
Special General Meeting	SGM
Special Resolution Unit	SRU
Standards of Fitness and Probity for Credit Unions	Standards
Supervisory Support Team	SST
The Credit Union Act, 1997	The 1997 Act
The Credit Union and Co-operation with Overseas Regulators Act 2012	The 2012 Act
The Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 as amended by the Criminal Justice Act 2013	CJA 2010
Treaty on the Functioning of the European Union	TFEU
World Council of Credit Unions	WOCCU

2. Introduction and Executive Summary

In introducing this report we think it will be helpful to describe the context within which the Central Bank of Ireland (Central Bank) now regulates and supervises credit unions in Ireland and the way in which supervision has progressed and developed over the period since 2003 when the Central Bank assumed responsibility for the regulation and supervision of credit unions. By doing this we hope that the reader will better understand the Central Bank's statutory remit in this area, the reasons for it and why we are making a number of recommendations, including those on engagement between the Central Bank as regulator and credit unions (the regulated community).

For more than 50 years credit unions have been in existence in Ireland. They play an important role in the Irish financial services landscape with 383 registered credit unions with total assets of €14.3bn providing services to over 3 million members. The credit union sector was impacted by the recent recession in Ireland, particularly in relation to loan performance and demand for new lending.

The Central Bank's statutory functions are set out in section 84 of the Credit Union Act, 1997 (the 1997 Act). This statute provides that the Central Bank shall administer the system of regulation and supervision of credit unions with a view toward:

- the protection by each credit union of the funds of its members, and
- the maintenance of the financial stability and well-being of credit unions generally.

The Central Bank's regulatory strategy for fulfilling its specific responsibilities in respect of the credit union sector are set out in its 2013-2015 Strategic Plan; this has three key objectives to:

- resolve weak and non-viable credit unions to protect members' savings and maintain financial stability within the credit union sector;
- develop an appropriate legislative and regulatory framework to protect the stability of individual credit unions and to allow the sector to develop; and
- bring about longer term restructuring of the sector to ensure its long-term stability.

Before May 2003 credit unions were regulated by the Registrar of Friendly Societies under the legislative requirements set out in the 1997 Act. In May 2003, with the establishment of the Irish Financial Services Regulatory Authority (IFSRA)¹, responsibility for regulation of the credit

¹ IFSRA was a separate but component part of the Central Bank and Financial Services Authority of Ireland.

union sector moved to that authority with a regulatory regime similar to that of other financial services providers. However, in recognition of the distinct nature and importance of credit unions, including the role of volunteers, a differentiated approach was put in place for the regulation for credit unions than was taken by IFSRA to other financial services providers.

The primary focus of the Registry of Credit Unions (RCU) was maintenance of the safety and security of members' savings within the regulatory powers and framework available at that time. However, the Registrar of Credit Unions did also publicly identify the need for change in the operation and governance of credit unions together with the need for modernization of the legislative framework.²

In 2008 Ireland began to experience the onset of an acute financial crisis. Before the crisis, Ireland's economy had been widely regarded as one of the most successful in the world, and from 2002 experienced high growth rates increasingly based on the rapid expansion of credit and an accompanying build-up of personal indebtedness by Irish households. From the summer of 2010 onwards, investors became increasingly concerned about the Irish banking sector and public finances. Funding of the banks and of the State became increasingly difficult and measures and plans aimed at restoring confidence and ensuring funding proved unsuccessful in improving the financing situation. Consequently, on 21 November 2010, the Irish authorities decided to request financial assistance from the European Union (EU) and International Monetary Fund (IMF).

On 25 November 2010 an external assistance package was agreed by the European Financial Stabilization Mechanism of the EU, the European Financial Stability Facility, and the IMF. One of the key elements underlying the support program was financial sector reform, including that the banking sector would be downsized, reorganized and its supervision strengthened. The components of the program that specifically related to the credit union sector included:

- completion of a full assessment of credit union loan portfolios;
- having a comprehensive strategy to enhance the viability of the sector; and
- introducing legislation to assist credit unions with a strengthened regulatory framework, including effective governance and stabilization requirements.

After the Crisis had broken, a report in 2010 by the Governor of the Central Bank, Patrick Honohan, into the banking crisis (The Irish Banking Crisis and Regulatory Financial Stability Policy 2003-2008) commented that the regulator had relied excessively on a regulatory philosophy "emphasizing process over outcomes" and noted, in summary that "it is clear that a

² Annual Report of the Financial Regulator 2008 – Registrar of Credit Unions' Statement

major failure in terms of bank regulation and the maintenance of financial stability occurred." In terms of changes to the structure of the authority responsible for regulation of the financial sector, the Central Bank Reform Act 2010 created a single unitary organization, the Central Bank, with responsibility of both central banking and financial regulation which replaced the Central Bank and Financial Services Authority of Ireland (CBFSAI). In 2010 the Central Bank assumed the responsibility for the regulation and supervision of regulated financial services providers, including credit unions. Within this revised structure the statutory position of Registrar of Credit Unions was retained with a reporting line to the Director of Credit Institutions.

Following on from a strategic review of the credit union sector in Ireland commissioned by the Central Bank at the request of the Minister for Finance, on 31 May 2011 a Commission on Credit Unions (CCU) was established by the Government to:

- review the future of the credit union movement in Ireland; and
- make recommendations in relation to the most effective regulatory structure for credit unions taking into account their not-for-profit mandate, the volunteer ethos, and community focus while paying due regard to the need to fully protect depositors' savings and financial stability.

The CCU's 2012 Report noted that although the penetration level of Irish credit unions was extremely high, it was not a mature movement owing to many factors, including limited product development, the failure to evolve the regulatory and prudential frameworks, failure to adopt an integrated Information Technology (IT) system for the delivery of services, and limited centralized service support. Among other things, the CCU recommended that:

- (i) the regulatory framework for credit unions should be strengthened, including more effective governance and regulatory requirements;
- (ii) Part 3 of the Central Bank Reform Act 2010 be commenced for credit unions providing the Central Bank with the powers to set out the Regulations and Standards of Fitness and Probity for credit unions;
- (iii) a Prudential Rule Book should be introduced to include prudential controls, limits, standards and requirements on key areas including: reserves; lending; investments; borrowing; members' savings; liquidity; governance; risk management systems and controls; and fitness and probity;
- (iv) the credit union sector should be restructured and that this should be achieved on a voluntary, incentivized and time-bound basis and overseen by a board established on a short-term basis;

- (v) a statutory steady-state stabilization mechanism be established for individual credit unions and the credit union sector as a whole;
- (vi) a Consultation Protocol should be put in place between the Central Bank and credit unions; and
- (vii) regulations should be proportionate to the nature, scale and complexity of the credit union.

Thus, it will be seen that in a relatively short time, Irish credit unions have moved from a system in place prior to 2003 which was effectively registration and a form of self-regulation, through a period, from 2003 to 2012, of tailored supervision based on available powers and non-statutory guidance to the current comprehensive, interventionist and outcome-driven, regulatory approach appropriate to a key financial sector in the Irish economy that is currently undergoing significant change in a challenging environment. At the same time, the regulatory responsibilities and powers of the Central Bank have increased significantly.

It is against this backdrop that we have undertaken the Credit Union Sector Peer Review. A number of our key recommendations reflect an acknowledgement of:

- the size and scope of the task undertaken by the Central Bank to date;
- the challenge that adaptation of the new regulatory regime has presented to Irish credit unions; and
- the continuing challenge for the Central Bank to ensure the embedding of the strengthened regulatory framework and to facilitate the restructuring and prudent development of the credit union sector to support its long-term viability.

A. Summary of Findings and Key Recommendations

Following is a summary of the overall findings of the ICURN Credit Union Peer Review after assessment of the legal, regulatory, and prudential supervisory and regulatory framework in place to fulfill the Central Bank's statutory mandate. The Central Bank effectively performs its functions in the regulation and supervision of the credit union sector in Ireland and has effectively undertaken the demanding task of introducing a comprehensive regulatory structure of credit unions. This has required gaining a sound understanding of the true health of the sector, bringing about essential restructuring as provided in legislation, delivering on requirements to protect members' funds and maintaining the financial stability and well-being of credit unions generally. The ICURN Credit Union Peer Review team (ICURN team) was also

impressed by the amount and quality of the work that has been undertaken by the Central Bank to implement the new regulatory framework for credit unions..

That said, following are possible refinements that the Central Bank can consider to enhance its performance as an effective regulator.

i. Supervisory Approach: The Central Bank's risk based supervisory framework, the Probability Risk and Impact System (PRISM), was introduced for credit unions in 2012. In view of the need for and value of on-site engagement and given that the current level of resources allocated to supervisory engagement under PRISM is only about 60% of the level of PRISM suggested supervisory resources, we recommend that the RCU should consider the way in which its PRISM framework is most effectively employed by RCU.

We acknowledge that PRISM has proved to be an effective and valuable tool in the short term, particularly in view of the need for considerable rapid change. In particular, refinements introduced with implementation of the 2015 Temporary Supervisory Engagement Model have somewhat mitigated the effect of this resource shortfall. These refinements include engagement with Low Impact credit unions and actually appear to be a very appropriate strategy given the low level of complexity of the business model, overall size of Irish credit unions and the current context of the Irish credit union sector. The Central Bank may wish to consider embedding some or all of these refinements into the supervisory engagement model on an ongoing basis.

Our review has led us to conclude that there are elements of the PRISM framework that might be modified or even omitted without material detriment to credit union supervision. For example, relieving supervisors of the requirement to comply with a governance and compliance framework best suited to the supervision of much larger and more complex financial institutions would produce an all-round benefit for RCU and the credit union sector. The central theme of many of our interviews and conversations with credit unions and with supervisors alike was the value that they gain from direct engagement with each other. We think that this aspect of the PRISM approach is fundamentally important and valuable in meeting the Central Bank's objectives but that maximum benefit would be produced by allowing supervisors more time to devote to "hands-on" supervisory activities. We think that this could be achieved by relieving supervisors of other elements of their work presently mandated by the PRISM framework, particularly those more administrative/system related tasks which are disproportionately demanding of time and effort. We also think that the PRISM governance and compliance framework should be adapted as appropriate for the credit union sector, while ensuring that key risk areas in credit unions are adequately addressed. Particular

attention should be focused on key risks, particularly the lending area of credit risk, that have real potential to cause challenges to credit unions' objectives and impact longer term viability. The Central Bank may also wish to concentrate its further review of IT risks on those credit unions which provide more complex products or services.

ii. Communication and Guidance: As objective observers we have both been impressed by the amount and quality of the work that has been done to implement the Central Bank's statutory remit, including new legal and regulatory requirements but also concerned at the sheer volume and (unavoidable) complexity of many of the requirements with which credit union boards of directors and management must now apply and comply. Communication must remain at the heart of the Central Bank's relationship with the sector. In particular, the level of engagement with individual credit unions should be enhanced to ensure the many changes to the regulatory framework and approach are absorbed and embedded. This enhancement could include consideration of additional guidance and more frequent on-site engagement. We acknowledge that this is extremely demanding of management and supervisors' time and attention. However, not only do we think that it is necessary at present, we also think that it will produce positive outcomes for the Central Bank as well as for credit unions and their members as, in time, exemplary credit unions step up to take a lead in encouraging and supporting their colleagues across the sector.

We also suggest that consideration be given by the relevant authority to directing a closely-defined, limited, review to evaluate the implementation of the original recommendations of the CCU and to propose any revisions or measures thought necessary in light of that experience. Such a review could possibly be undertaken by the Credit Union Advisory Committee (CUAC), if permissible under its Terms of Reference, with whom we met, as part of its important work in maintaining the impetus stemming from the CCU's Report. We accept that this is not itself a matter for the Central Bank, but we simply note that we think such an exercise might prove valuable for both the Central Bank and for Irish credit unions in general.

iii. Resourcing: Having undertaken the demanding task of introducing a comprehensive regulatory structure for credit unions, of gaining a sound understanding of the true health of the sector, and bringing about essential restructuring, the Central Bank should consider refocusing its attention, and scarce resources, on key risks, particularly credit risk, that have real potential to cause material damage to its objectives. Poor-quality underwriting and a failure to understand and apply the principles of sound lending have been, and remain, significant problems for many Irish credit unions. Achieving a permanent improvement in those areas will take considerable time and will not be achieved without continued focus and attention across the sector by the Central Bank. RCU needs to ensure that it has the adequate

level of resources necessary to deliver on all aspects of its regulatory strategy. The required level of resources will also need to take into account any additional resourcing requirements arising from the recommendations contained above and on pages 40-44 in relation to "Supervisory Approach" and "Communications and Guidance."

3. Scope and Methodology

Section 32M of the Central Bank Act, 1942 states that:

At least every 4 years the Bank shall make appropriate arrangements for -

(a) another national central Bank, or

(b) another person or body certified by the Governor, after consultation with the Minister, as appropriate,

to carry out a review of the Bank's performance of its regulatory functions.

For the purposes of section 32M(b) of the Central Bank Act, 1942, following consultation with the Minister for Finance, the Central Bank requested the International Credit Union Regulators' Network (ICURN) to carry out a peer review on the Central Bank's performance of its functions in relation to credit unions (ICURN Credit Union Peer Review).

Members of the ICURN team are regulatory representatives from the United States; from the United Kingdom; and from Ontario, Canada as follows:

- Mary Martha Fortney (United States), the retired president and CEO of the National Association of State Credit Union Supervisors (NASCUS) - the professional regulators association representing the credit union regulatory agencies in the United States, has a clear understanding of regulatory and supervisory processes. Under her leadership, she successfully transformed the NASCUS Accreditation Program into the national standard for credit union supervisory excellence, increasing the number of accredited states from 7 to 28. She has worked extensively with the international regulatory community during her 23-year tenure at NASCUS, representing the association on the ICURN Steering Committee. Fortney worked for the U.S. House of Representatives and for U.S. President Jimmy Carter and attended James Madison University and George Mason University. Fortney served as team leader of the ICURN Credit Union Peer Review.

- Roger Little (United States) retired from the Michigan Office of Financial and Insurance Services in December 2010, having served in various positions of increasing responsibility from March 1984, including as Deputy Commissioner Credit Unions where he had full responsibility for a 44-person staff and approximately 220 credit unions in Michigan. As Deputy Commissioner, Little oversaw various initiatives, including a full rewrite of the Michigan Credit Union Act. He served as NASCUS Chairman for two years, and currently administers the NASCUS Accreditation Program under the direction of the NASCUS CEO and the Performance Standards Committee. Little graduated cum laude from Central Michigan University, is a graduate of the Graduate School of Banking of the South, Louisiana State University, and a Certified Public Accountant.
- Roger Marsh (United Kingdom) is Manager of the Credit Unions Supervision Team in the Prudential Regulation Authority, Bank of England, responsible for the prudential supervision of UK credit unions and for credit union prudential policy. Marsh has held various positions with supervisory bodies in the UK since 1993, originally in enforcement roles and later as a supervision manager. Marsh is Solicitor, England & Wales, Attorney at Law, New York, and has practiced as a Solicitor in New South Wales and the Australian Federal Jurisdiction. He is a Member of the Chartered Institute of Arbitrators.
- Richard White (Ontario, Canada) has almost 40 years' experience in the financial service sector, with 19 years at the Deposit Insurance Corporation of Ontario, Canada (DICO), the deposit insurer and solvency regulator for Ontario credit unions and caisses populaires. While at DICO, he has worked on a number of key initiatives and projects, including revisions to legislation, updating and promoting standards of sound business and financial practices and related guidance, examination processes and practices, a differential premium system and deposit insurance reserve fund model. White has also worked with a number of sector and industry representatives on developing sample tools for director training and qualifications, loan loss provisioning, enterprise risk management, stress testing and an internal capital adequacy assessment process. He is a Certified Professional Accountant (CPA, CMA) - Institute of Professional Accountants, Toronto, Canada.

The Central Bank Credit Union Sector Peer Review Report was reviewed and evaluated by the ICURN Review Task Force comprised of ICURN Steering Committee Chairman Martin Stewart, Director of Banks, Building Societies & Credit Unions, Prudential Regulation Authority, Bank of England; John Kutchey, Deputy Executive Director of the National Credit Union Administration in the United States; and Andy Poprawa, Chief Executive Officer, Deposit Insurance Corporation

of Ontario, Canada. ICURN is an independent international network of statutory credit union regulators that promotes the guidance given by the leaders of the Group of 20 (G-20) nations for greater international coordination among financial services regulators. ICURN was formed in 2007 and currently has members in over 30 countries and jurisdictions. It facilitates the sharing of information and positions of common interest among financial cooperatives, initiates research on financial cooperatives and their oversight, identifies best practices and provides direct access to an exclusive forum for thought leaders worldwide on issues critical to sound credit union regulation. ICURN publishes the *Guiding Principles for Effective Prudential Supervision of Cooperative Financial Institutions* and *Guiding Principles for Corporate Governance, using the Basel Committee's Core Principles for Effective Banking Supervision* as a guide. ICURN's secretariat is provided by the World Council of Credit Unions (WOCCU).

The ICURN Credit Union Peer Review assessed the legal, regulatory, and prudential supervisory framework in place to fulfill the Central Bank's statutory mandate under section 84 of the 1997 Act which requires the Central Bank to administer the system of regulation and supervision of credit unions with a view to the protection by each credit union of members' funds and the maintenance of the financial stability and well-being of credit unions generally.

The ICURN Credit Union Peer Review focused on the legal and regulatory framework for the regulation of credit unions in effect at the time of the on-site review (13-17 April 2015).

The review took account of the Central Bank's current strategy for the credit union sector including:

- the Central Bank Strategic Plan 2013-2015 and implementation of that strategy to date; and
- any changes proposed to the regulatory framework for credit unions, including as set out in public Consultation Papers (CPs).

The performance of the Central Bank's functions in the regulation and supervision of credit unions was assessed against the 2011 *ICURN Guiding Principles for Effective Prudential Supervision of Cooperative Financial Institutions*. Taking into account financial cooperatives' unique nature and using *Basel Committee's Core Principles for Effective Banking Supervision (2006)* as a guide, the document developed by ICURN incorporates 21 Guiding Principles conducive to developing an effective supervisory system for credit unions. In addition, the ICURN Credit Union Peer Review included two additional Guiding Principles on Governance and Major Acquisitions to take account of updates to the Basel Principles in 2012 and the restructuring of the credit union sector that is currently underway in Ireland. Guiding Principle

22 is based on Guiding Principles 13-17 contained in the *ICURN Guiding Principles for Enhancing Governance of Cooperative Institutions (2013)* and Guiding Principle 23 "Major Acquisitions" is informed by *Basel Core Principles for Effective Banking Supervision (2012)* Core Principle 7.

In advance of the on-site engagement, RCU provided a detailed credit union self-assessment document (CUSAD) setting out background on the credit union sector in Ireland and a detailed assessment of the Central Bank's observance of each of the 23 Guiding Principles. During the on-site engagement, the ICURN team conducted numerous interviews with key personnel of the Central Bank and RCU, including the Director of Credit Institutions, the Registrar of Credit Unions, the two Deputy Registrars, and numerous staff involved in the following areas: Intervention & Restructuring (I&R), Policy, Departmental Operations, Off-Site Financial Analysis and Credit Union Supervision.

In addition to RCU staff, the ICURN team met with staff from the following divisions: the Special Resolution Unit (SRU), the Legal Division, the Enforcement Division, the Anti-Money Laundering Division (AMLD), and the Risk, Governance and Accounting Policy Division.

Extensive review of documentation and processes also occurred on-site during the ICURN Credit Union Peer Review. Documentation was provided during the ICURN Credit Union Peer Review in addition to that contained in the CUSAD, including supervisory documentation and files and examples of actual supervisory practices and assessment. Numerous interviews were conducted with external stakeholders, including the following:

- Audit Firms
- the CUAC
- the Credit Union Managers Association (CUMA)
- the Credit Union Development Association (CUDA)
- the Credit Union Restructuring Board (ReBo)
- the Department of Finance
- Irish Credit Unions
- the Irish League of Credit Unions (ILCU)
- the National Supervisors Forum (NSF), representing the Board Oversight Committee (BOC).

The ICURN team prepared the following assessment report which includes a description, findings, and an assessment of compliance in relation to each of the 23 Guiding Principles. The ICURN Credit Union Peer Review referred to the grading category terms and descriptions which are used by the IMF when assessing regulatory authorities' compliance with the Basel Core

Principles for Effective Banking Supervision (see Summary Assessment, pages 52-58). In assessing each Guiding Principle, the ICURN team used their own methodology when considering the criteria as set out in pages 52-53. The assessments were based on the ICURN team's review and judgment of the information it received prior to and during the on-site engagement. These ratings are not in any way to be taken or held out as assessments based on the IMF methodology.

The assessment report was made in the context of the Irish credit union sector's structure and complexity, recognizing the distinctive features of credit unions and the Irish credit union sector. The assessment recognized that the Central Bank's supervisory practices were commensurate with the complexity, size, and risk profile of the credit union sector and the individual credit unions supervised. The assessment also took into consideration strategic matters, including the restructuring of the credit union sector currently underway in Ireland.

A. Basis of Information

The financial information contained in section 4.B. (Overview of the Credit Union Sector) and section 4.C. (Developments in the Credit Union Sector Since 2010) and other tables contained in this report, is based on information reported by credit unions on the December 2014 Prudential Returns, unless noted otherwise. Other statistical information contained in this report reflects the position as of 31 March 2015.

4. Environmental Context for the Prudential Supervision of Credit Unions

A. Macroeconomic Environment

At the time of the review, the Central Bank's most recent Macro Financial Review 2014.2 had been issued in December 2014. This review offers an overview of the current state of the macro-financial environment in Ireland and includes an assessment of a number of risks to financial stability in Ireland as well as an overview of the financial system environment, including the Irish credit union sector. In summary, the overview notes the following:

- the international economic environment has been less favorable since the publication of the last review (June 2014);
- there is a slowdown in economic activity in the euro area; and
- there are heightened geopolitical tensions and challenges associated with monetary policy normalization in some countries and protracted below-target inflation in others.

Against this background, the performance of the Irish economy has been improving with output projections for 2014 and 2015 revised upward. The economic recovery is also becoming more broadly based with domestic demand estimated to be now making a positive contribution to Gross Domestic Product (GDP) growth. However, the issues weighing on the macro-financial environment, including high debt burdens in the private and public sectors and a large stock of non-performing bank loans, plus a number of geopolitical issues could have negative consequences for the Irish financial system. A high saving rate and subdued activity in the housing market may weigh on consumption.

B. Overview of the Credit Union Sector

i. Financial Position

The following table provides a high level summary of the financial position of the Irish credit union sector as at 31 December 2014. This information is based on the quarterly Prudential Returns submitted by credit unions, with the exception of the dividend information, which is based on annual financial statements submitted by credit unions.

Table 4.1 Credit Union Sector Overview as at 31 December 2014

Assets: €14.3 billion	Savings: €12.0 billion
<ul style="list-style-type: none"> • 383 credit unions registered as at 31 December 2014³. (376 registered credit unions as at 31 March 2015.) • 178 credit unions with total assets of less than €20m 	<ul style="list-style-type: none"> • €10.3 billion savings reported as unattached to loans
<ul style="list-style-type: none"> • 31 credit unions with total assets over €100m 	

³Information provided by the Central Bank: There were 383 credit unions registered as at 31 December 2014. Four (4) credit unions that have been the subject of resolution actions, Newbridge, Howth Sutton, Berehaven and Killorglin are included in the 383 registered credit unions but no longer submit Prudential Returns. Three (3) other credit unions that did not report for this period were subsequently de-registered as credit unions. One other credit union had not yet reported for the period. Therefore, the analysis in this table is based on the Prudential Returns submitted by 375 credit unions for 31 December 2014 at the time of this report.

Loans: €4.0 billion	Total Reserves⁴: €2.3 billion
<ul style="list-style-type: none"> Average loans to assets ratio: 29% (Dec 2013: 32% and Dec 2012: 36%) 	<ul style="list-style-type: none"> 10 credit unions with realized reserves⁵ below the 10% Regulatory Requirement, as reported by the credit unions themselves (These are being dealt with by the I&R team.)
<ul style="list-style-type: none"> 152 credit unions with loans to assets ratio below 25% 	
<ul style="list-style-type: none"> 30% (112 CUs) have gross loans in arrears greater than 20% of their total loans 	<ul style="list-style-type: none"> The average dividend for 2014 to date across the sector is below 1%⁶
<ul style="list-style-type: none"> 5% (17 CUs) have less than 70% provision coverage for loans in arrears 	
Investments: €10.2 billion	
<ul style="list-style-type: none"> Over 76% held in bank deposit accounts, 20% held in Bank Bonds/Government Securities 	
<ul style="list-style-type: none"> Liquidity ratio average of 47% 	

The tables below provide a high level overview of the credit union sector in Ireland over time. Although there has been a decline in the number of credit unions, the number of members and total assets have remained largely the same as shown by the following two tables.

⁴Information provided by the Central Bank: Total Reserves is as per the categorization in the Prudential Returns submitted by credit unions and includes unrealized reserves and any proposed dividend and interest rebate.

⁵Information provided by the Central Bank: The number of credit unions that have reported reserves below the regulatory requirement is calculated based on credit unions' total realized reserves (excluding any proposed dividend/interest rebate) and including any surplus or deficit for the year to date.

⁶Information provided by the Central Bank: As reported in the final financial statements for the year ended 30 September 2014 at the time of the report.

Table 4.2 Number of Registered Credit Unions and Members

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014
Number of Registered Credit Unions	428	422	419	414	409	404	399	393	383
Number of Members (Millions)	2.8	2.9	2.9	2.9	3.0	3.1	3.1	3.1	3.1
Total Assets (€m)	14,372	14,350	14,196	14,467	14,309	13,781	13,710	13,867	14,331

Table 4.3 Number of credit unions by asset bands as at 31 December 2014⁷

Asset Bracket	Number	Total Assets (€m)	% Total Assets
< €20m	181	1,862	13
>€20m<€40m	86	2,495	18
>€40m<€60m	45	2,197	15
>€60m<€100m	36	2,755	19
>€100m	31	5,077	35
Total	379	14,386	100

The following table provides a high level overview of the financial position and performance of the Irish credit union sector over time.

⁷ Information provided by the Central Bank: Source of information is the December 2014 Prudential Return for the 375 credit unions that reported in December 2014. Most recent return submitted used for other four credit unions.

Table 4.4 Credit Union Sector Financial Position

	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Assets (€m)	14,372	14,350	14,196	14,467	14,309	13,781	13,710	13,867	14,331
Total Loans (€m)	6,547	6,851	7,274	6,767	6,262	5,538	4,881	4,265	3,890
Total Investments (€m)	7,251	6,955	6,389	7,286	7,843	7,978	8,722	9,474	10,211
Total Realized Reserves (€m)	1,598	1,711	1,674	1,790	1,734	1,778	1,966	2,078	2,240
Total Savings (€m)	12,675	12,541	12,402	12,548	12,458	11,896	11,639	11,687	11,994
Arrears Greater than 9 weeks (€m)	411	420	513	747	1,012	1,021	941	766	620
Average Arrears (%)	7%	7%	8%	12%	17%	19%	20%	19%	17%
Average Liquidity	34%	32%	30%	34%	40%	47%	45%	49%	47%
Average Loans to Asset Ratio	47%	49%	52%	48%	44%	41%	36%	32%	29%
Average Return on Assets	3.3%	3.5%	2.4%	1.6%	0.7%	0.6%	2.0%	1.7%	1.7%
Average Dividend Proposed	2.2%	2.3%	1.8%	1.2%	0.7%	0.6%	0.9%	0.8%	0.7%

Source: Average Return on Assets and Average Dividend Proposed is based on information reported by credit unions on Year End Returns

ii. Credit Unions Not Meeting Reserve Requirements

At 31 December 2014, 10 credit unions reported that they were not meeting the minimum regulatory reserve requirement of 10% of total assets.⁸ Of these, five credit unions had regulatory reserves less than 7.5% of total assets. These are credit unions under the supervision of the Intervention and Restructuring (I&R) team.

⁸ Information provided by Central Bank: These credit unions were subject to further regulatory actions to address their financial position. By 31 May 2015, four of these credit unions had completed a transfer of engagements to another credit union.

Credit unions that do not meet the minimum regulatory reserve requirements are instructed by RCU to restore their reserves position to meet the minimum regulatory reserve requirement within a specified period of time. These instructions take the form of regulatory directions given under section 87 of the 1997 Act. In some cases, credit unions obtain Savings Protection Scheme (SPS) support from the ILCU to assist them in restoring their reserves position. Since 2009, SPS support has been provided on approximately 50 occasions to approximately 40 individual credit unions with the majority of cases having occurred since 2011.

C. Developments in the Credit Union Sector since 2010

i. Strategic Review

The Minister for Finance in 2009 requested that RCU carry out, on behalf of the Central Bank, a strategic review of the credit union sector in Ireland. This strategic review was undertaken by Grant Thornton in 2010 with the report completed and provided to the Minister for Finance in January 2011. The *Strategic Review of the Irish Credit Union Sector* made an assessment of the risk profile of the credit union sector and provided specific proposals to strengthen the prudential soundness of the sector. The Strategic Review report identified significant financial weaknesses within the sector, with a number of credit unions facing possible viability concerns over the short term. The report also highlighted significant deficiencies in the regulatory framework in place at that time, in particular the following:

- the lack of governance and competency requirements;
- the lack of powers available to the Central Bank for preventative intervention where credit unions were showing signs of financial difficulty; and
- the limitations of the external support mechanisms to facilitate credit union access to liquidity and capital.

ii. Prudential Capital Assessment Review

Arising from the Strategic Review report findings, the Central Bank carried out the 2011 Credit Union Prudential Capital Assessment Review (PCAR) whose purpose was to assess the capital adequacy of the credit union sector for 2011-2013 under base and stress macro-economic scenarios. The PCAR, performed on data provided by credit unions, identified a significant potential shortfall in reserves for the sector deriving from the scenarios used, and as a result, credit unions requiring increased supervisory focus by RCU were identified.

iii. Loan Book Assessments

In 2011 the Central Bank completed an assessment of the individual loan book portfolios of credit unions in order to establish the adequacy of provisions for bad and doubtful debts at the time of inspection and to identify levels of additional provisions required. It was found that 66% of the 401 credit unions inspected needed to make additional provisions for bad and doubtful debts at that time. All credit unions inspected were provided with action plans arising from the inspections, setting out the provisioning changes and process changes required to undertake to remedy the deficiencies and the timeframes for undertaking these actions.

iv. Regulatory Actions Taken Since the Loan Book Assessments and PCAR

Since the PCAR and loan book reviews in 2011, the Central Bank has continued to focus on building reserves and provisions in the credit union sector through various regulatory interventions, including curtailing dividend payments and placing restrictions on the business of individual credit unions on a case-by-case basis, such as restricting the level of lending undertaken. Lending restrictions have been imposed in individual credit unions arising from concerns relating to weakness in governance, credit practices, and systems and controls for lending and credit control in those credit unions. At the time of the ICURN Credit Union Peer Review, approximately 53% of credit unions had some form of lending restriction. In February 2015 the Central Bank commenced a lending restriction review initiative whereby credit unions that are subject to a lending restriction may apply for a review of their lending restriction if the Central Bank is satisfied that they have made the necessary improvements and have embedded these improvements in robust risk sensitive lending practices. In addition, a targeted asset review program that facilitates specific regulatory actions began in 2012. The asset review program has subsequently been undertaken in a number of credit unions with increased risk profiles to determine any shortfall in the capital base of the selected credit unions and remediation actions required. To date a total of c.70 such asset reviews have been or are being undertaken as part of this program.

On 31 May 2011 the Commission on Credit Unions (the CCU) was established in accordance with the Program for National Government 2011-2016. Its purposes were 1) to review the future of the credit union movement in Ireland; and 2) to make recommendations in relation to the most effective regulatory structure for credit unions, taking into account their not-for-profit mandate, their volunteer ethos, and community focus while paying due regard to the need to fully protect depositors' savings and financial stability. Nearly one year later, on 31 March 2012 the CCU presented its final report to the Minister for Finance. The CCU's recommendations are found in section 2 of this report.

Over 60 of the CCU recommendations across an extensive range of areas - prudential regulation and governance, restructuring and stabilization - were implemented in the enactment of the

2012 Act on 19 December 2012. Following are key areas of the CCU recommendations that have been implemented to date:

- New Governance and Prudential Requirements
- Fitness and Probity
- Credit Union Handbook
- Stabilization Support
- Consultation Protocol for Credit Unions
- Consultation on Tiered Regulatory Approach
- Consultation on New Regulations.

v. New Governance and Prudential Requirements

The 2012 Act is being commenced on a phased in basis with the majority of the new requirements introduced on 11 October 2013 and a small number commenced on 3 March 2014. Included in the new requirements are a new governance framework that sets out the roles and responsibilities of key elements of the credit union governance structure and new requirements in such areas as risk management, compliance, internal audit, strategic planning, operational risk, business continuity, information systems, records management and outsourcing. Credit unions are now required to submit an annual compliance statement, the BOC is required to report to members at the Annual General Meeting (AGM), and there are provisions relating to the board of directors, including persons not eligible to be on the board of directors and reduction in the maximum size of the board of directors. There are a number of remaining items due to be commenced including sections on reserves, liquidity lending, investments, savings, and borrowings (see section 4.C.xi. (Consultation on New Regulations) for further details).

vi. Introduction of Fitness and Probity

On 24 September 2012 the Minister for Finance commenced Part 3 of the Central Bank Reform Act 2010 for credit unions, and on 19 December 2012 the Central Bank issued CP62, Fitness and Probity Regime for Credit Unions. Following this consultation, a new Fitness and Probity regime for credit unions came into effect on 1 August 2013 and is being implemented in two phases: requirements for those credit unions with total assets greater than €10 million (1 August 2013), and for all remaining credit unions (1 August 2015).

vii. Credit Union Handbook and Other Regulatory Guidance

To provide clarity to credit unions and assist them in implementing the strengthened regulatory framework the *Credit Union Handbook* was issued prior to the introduction of the new requirements contained in the 2012 Act. An extensive and comprehensive document, the

Credit Union Handbook brings together in one place a number of legal and regulatory requirements and guidance that apply to credit unions and sets out the Central Bank's expectations in relation to the steps credit unions should undertake in meeting legal and regulatory requirements. The *Credit Union Handbook* contains 23 chapters across the regulatory framework, including chapters on reserves, lending, liquidity, investments, savings, borrowings, governance, risk management and compliance, internal audit, and fitness and probity.

The *Credit Union Handbook* also contains a number of Appendices and Frequently Asked Questions documents to assist credit unions in their implementation of new requirements. Updates and amendments made to the regulatory framework are incorporated into the relevant chapter(s) of the *Credit Union Handbook*. In addition, the Central Bank communicates with the credit union sector on new and updated regulatory requirements and guidance through a variety of communication channels, including annual nationwide information seminars, speeches and presentations at credit union sector events, and a twice yearly credit union newsletter.

viii. Stabilization Support

As recommended by the CCU, the 2012 Act provides for the establishment of statutory stabilization for the credit union sector to provide financial support to viable but undercapitalized credit unions. Credit unions must also have regulatory reserves above 7.5% of total assets to be considered for stabilization support. In addition, during the period the ReBo is in existence the Central Bank may not approve stabilization support unless ReBo has recommended that a credit union be considered for such support. See pages 29-30 for further details on stabilization support.

ix. Consultation Protocol for Credit Unions

Further to the CCU recommendations, in 2012 the Consultation Protocol for Credit Unions was published, setting out how the Central Bank consults formally with credit unions, their representative bodies and other relevant stakeholders prior to the introduction of new regulations for credit unions. To date, RCU has consulted on a Fitness and Probity Regime for Credit Unions (CP62), the Introduction of a Tiered Regulatory Approach for Credit Unions (CP76), a Fitness and Probity Regime for Credit Unions that are also authorized as Retail Intermediaries (CP83), and Consultation on Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act (CP88).

x. Consultation on Tiered Regulatory Approach

The CCU recommended that regulations should be proportionate to the nature, scale, and complexity of the credit union and set out high level proposals on a tiered regulatory approach. The Central Bank published CP76 on 23 December 2013 which sets out its approach to tiered regulation, taking into account the CCU's recommendations, the extent to which tiering currently exists in the regulatory framework for credit unions and the existing business model in Irish credit unions.

Following the consultation on CP76, on 30 June 2014 the Central Bank published the submissions received along with a feedback statement on the consultation. The feedback statement noted that the majority of respondents were of the view that a tiered regulatory approach should not be introduced at that time, given the amount of change the credit union sector was undergoing, arising from the introduction of the strengthened regulatory framework and the voluntary restructuring of the sector.

The feedback statement indicated that, having considered the feedback received on timing, the Central Bank was not proposing to introduce a tiered regulatory approach for credit unions at that stage. However, the Central Bank set out a number of steps it planned to take in relation to the development of the regulatory framework for credit unions including:

- developing regulations for all credit unions under the regulation making powers in the 2012 Act; and
- further engagement and consultation with credit unions and other sector stakeholders on the prudent development of the credit union sector and the regulatory framework for credit unions.

xi. Consultation on New Regulations

On commencement of the remaining sections of the 2012 Act, the 1997 Act will be amended to provide regulation making powers to the Central Bank, including regulation making powers on reserves, liquidity, lending, investments, savings, and borrowings. As indicated in the feedback statement on CP76, on 27 November 2014 the Central Bank published CP88 along with a Regulatory Impact Analysis (RIA) on the draft regulations.

The draft regulations set out in CP88 contain requirements that will apply to all credit unions in the following areas: Reserves; Liquidity; Lending; Investments; Savings; Borrowing; Systems, Controls and Reporting Arrangements; and Services Exempt from Additional Services Requirements.

The proposed timelines set out in CP88 indicate that final regulations will be published at the end of June and following a six month transition period, that the remaining sections of the 2012 Act will be commenced and the regulations will be introduced at the end of 2015.

The consultation period for CP88 closed on 27 February 2015 and the responses were being reviewed at the time of the ICURN Credit Union Peer Review on-site evaluation.

D. Legal and Regulatory Framework

There is an extensive legal and regulatory framework in place for the Irish credit union sector.

Following are the main pieces of legislation relevant to credit unions:

- Central Bank Act, 1942
- Credit Union Act, 1997
- Central Bank Reform Act 2010
- Central Bank and Credit Institutions (Resolution) Act 2011
- Credit Union and Co-operation with Overseas Regulators Act 2012 and
- Central Bank (Supervision and Enforcement) Act 2013.

The Central Bank Act, 1942

This Act sets out the functions and powers of the Central Bank and also establishes a statutory position, the Registrar of Credit Unions. The Central Bank Act, 1942 sets out the process for the appointment, role and responsibilities of the Registrar of Credit Unions.

The Credit Union Act, 1997

This Act sets out the functions and powers of the Central Bank in relation to credit unions. The functions of the Central Bank are delegated to the Registrar of Credit Unions. The 1997 Act sets out the framework for the registration, regulation, and operation of credit unions.

Central Bank Reform Act 2010

This act establishes a new single unitary body responsible for both central banking and financial regulation. The 2010 Act also provides the Central Bank with the powers to set out the Regulations and Standards of Fitness and Probity for regulated financial service providers, including credit unions.

The Central Bank and Credit Institutions (Resolution) Act 2011

This legislation provides the Central Bank with powers to manage and resolve distressed credit institutions, including credit unions.

Credit Union and Co-operation with Overseas Regulators Act 2012

The 2012 Act took into account many of the CCU recommendations in areas such as prudential regulation, governance, restructuring and stabilization.

Central Bank (Supervision and Enforcement) Act 2013

Enacted on 11 July 2013 this Act represents an enhancement of the supervisory and enforcement powers of the Central Bank. Many provisions are now harmonized across all regulated financial service providers rather than being applicable to one industry sector alone. Key elements of the 2013 Act include whistle-blower protections, Central Bank regulation-making powers in such areas as conduct of business and consumer protection, and the power to require a regulated financial service provider to commission the production of an expert report by a third party.

Anti-Money Laundering Legislation

In addition to the above, there is anti-money laundering legislation with which credit unions are required to comply. The Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (CJA 2010), amended by the Criminal Justice Act 2013, transposes the Third Money Laundering Directive (2005/60/EC) and its Implementing Directive (2006/70/EC) into Irish law, bringing Ireland into line with EU requirements and the recommendations of the Financial Action Task Force (FATF). Designated persons under the CJA 2010, including credit unions, are required to comply with their obligations under the CJA 2010.

E. Accounting and Audit

The 1997 Act sets out the requirement for the preparation of the accounts of a credit union and the audit thereof. Section 111 of the 1997 Act requires the credit union directors to prepare a) an income and expenditure account giving a true and fair value of the credit union's income and expenditures; b) a balance sheet; and c) any statement required by a body of accountants to be included with the annual accounts. The requirement for the annual accounts of Irish credit unions is regarded as requiring compliance with local Generally Accepted Accounting Principles (GAAP) as well as the 1997 Act or with International Financial Reporting Standards (IFRS) endorsed in the EU. Given the size and nature of most credit unions, it is more usual that local GAAP is applied. Local GAAP comprises accounting standards (Financial Reporting Standards -

FRSs) and other pronouncements issued by the Financial Reporting Council (FRC) in the United Kingdom and promulgated in Ireland by the Chartered Accountants Ireland.

The FRC issued new standards (new local GAAP; FRS 100-FRS 103) to replace all existing local accounting standards effective for accounting periods commencing from 1 January 2015 with earlier adoption allowed. Credit unions are currently preparing to adopt FRS 102, the relevant accounting standard that will apply to them under new local GAAP. New local GAAP requires additional financial instruments disclosures developed by the FRC which are proportionate and based on IFRS 7 Financial Instruments Disclosures. The FRC has also issued Practice Notes setting out specific considerations the auditor should take into account when auditing a specific type of institution.

Auditors in Ireland apply International Standards on Auditing as issued by the FRC. These standards are based on standards issued by the International Auditing and Assurance Standards Board (IAASB), supplemented with additional standards and guidance to address specific Irish legal and regulatory requirements and additional guidance that is appropriate in the Irish national legislative, cultural and business context. Auditors are required to comply with Ethical Standards published by the FRC, professional ethics requirements in legislation and any standards of professional conduct issued by the auditor's own Recognized Accountancy Body (RAB).

The Irish Auditing and Accounting Supervisory Authority (IAASA) oversees how the Prescribed Accountancy Bodies (PABs) exercise supervision of their members, auditors, accountants and students. Members of the PABs are regulated by the PABs themselves. Thus, the PABs are the primary supervisors of members of the Accountancy Bodies with IAASA's having a secondary, less active oversight role. However, IAASA has the power under existing legislation to intervene in the investigation and disciplinary procedures of PABs and the power to conduct its own inquiries following the receipt of a complaint or on its own initiative.

F. Financial Safety Net

Deposits held in credit institutions (banks, building societies and credit unions) authorized in Ireland are protected by the Deposit Guarantee Scheme (DGS). In addition to the DGS protection, other supports have been put in place for credit unions, including a Credit Union Fund for restructuring and stabilization purposes and a resolution fund.

i. Deposit Guarantee Scheme (DGS)

In Ireland, in the event of a credit institution being unable to repay deposits, all eligible deposits are guaranteed to be repaid by the DGS up to a limit of €100,000 per person per institution. The DGS is administered by the Central Bank and is funded by the credit institutions covered by the scheme. Each credit institution is required to maintain a Deposit Protection Account (DPA) equivalent to 0.2 % of their total deposits. The DGS was established under the terms of:

- 1) the European Communities (Deposit Guarantee Schemes) Regulations, 1995 (S.I. No. 168 of 95) and amended by European Communities (Deposit Guarantee Schemes) (Amendment) Regulations, 2009 (S.I. No. 228 of 2009); and
- 2) the Financial Services (Deposit Guarantee Schemes) Act 2009. The DGS has issued compensation to depositors twice to-date, one occasion following the liquidation of Berehaven Credit Union on 23 July 2014.

EU Directive 2014/49/EU on deposit guarantee schemes was due to be transposed by the Department of Finance into Irish law on 3 July 2015. The transposition of this directive will introduce a number of changes to the DGS, including the removal of some previous exclusions from the scheme such as large and medium sized companies and a new provision for the coverage of temporary high balances, whereby certain deposits in excess of €100,000 may be temporarily covered. There will be additional changes to the financing, including that DGS contributions will be based on covered deposits rather than total deposits, that the DGS contribution will increase from 0.2% of total deposits to 0.8% of covered deposits by July 2024, and that DGS contributions will be risk weighted. EU member states have a number of discretions on how the DGS directive will be implemented, and the Department of Finance is currently consulting on the discretions⁹.

ii. Restructuring Support

Following a CCU recommendation, ReBo was established on 1 January 2013 in accordance with the 2012 Act as the statutory body responsible for facilitating and overseeing the restructuring of credit unions to support their financial stability and long-term sustainability on a voluntary, time bound and incentivized basis. The 2012 Act provides that the Minister for Finance will review the operation of ReBo not later than 1 January 2016, and after consultation with the appropriate persons, the Minister for Finance will determine whether ReBo has completed the performance of its functions.

⁹ The Department of Finance's consultation on Directive 2014/49/EU on deposit guarantee schemes is available at the following [link](#).

The Minister for Finance contributed €250 million for restructuring purposes to the statutory Credit Union Fund. This funding is available to support the credit union sector restructuring process by providing a source of funds to meet one-half of the expenses of ReBo. The Credit Union Fund is also a source of recoupable financial support to credit unions for capital or other funding requirements identified as part of a restructuring proposal. Any financial support provided by the Credit Union Fund for restructuring purposes must be repaid by the credit union receiving financial support.

This provision of recoupable financial support falls within the EU State Aid requirements. Approval for the scheme was obtained by Ireland from the European Commission in October 2014. There are two scenarios where the European Commission requires notification of the process: 1) where the restructuring credit union has total assets in excess of €100 million and regulatory reserves of less than 10%; and 2) where the total assets of the credit union post-restructuring exceed €400 million.

The Credit Union Fund has not been used to provide financial support to credit unions involved in restructuring to date. ReBo, however, has supported credit unions in transferring their engagements to another credit union by way of providing funding, from its operational expenses, to cover certain amounts for due diligence and staff related costs.

iii. Stabilization Support

A legislative basis for statutory stabilization support for credit unions was established by the 2012 Act, which enables the Minister for Finance to provide stabilization support to credit unions from the Credit Union Fund. The Central Bank must approve the provision of stabilization support and request such support from the Minister for Finance. The 2012 Act specifies that the Central Bank can only approve stabilization support in certain conditions, including the requirement for credit unions to have regulatory reserves equal to or greater than 7.5% of total assets, and where in the opinion of the Central Bank, the credit union is viable as a credit union.

During the period in which ReBo is in existence¹⁰ the Central Bank may not approve stabilization support unless ReBo has recommended that a credit union be considered for stabilization support. To date ReBo has not recommended that any credit union be considered for stabilization support.

¹⁰ See Section 43 of the 2012 Act.

Any stabilization support provided from the Credit Union Fund must be repaid by the credit union receiving stabilization support.

On 26 November 2014 the Minister for Finance signed into law the Credit Union Fund (Stabilization) Levy Regulations 2014¹¹ giving effect to the introduction of a stabilization levy to provide stabilization support for credit unions under the Stabilization Scheme. The target level of funding for stabilization support in the Credit Union Fund is €30 million to be built up over 10 years. The levy rate is 0.022% of the credit union's total assets and the Department of Finance will review the levy rate after three years. The first levy payment deadline was 28 February 2015. Further, the Stabilization Scheme will be reviewed by the Department of Finance at the end of three years to assess its effectiveness.

iv. Other Private Sector Stabilization Support

The SPS is the private sector stabilization fund operated by one of the credit union representative bodies. The SPS may provide assistance to credit unions affiliated with the ILCU that are experiencing financial difficulties. See Section 4.B.ii. (Credit Unions Not Meeting Reserve Requirements) for further details on credit unions obtaining support from the ILCU's SPS.

G. Restructuring and Resolution

As recommended by CCU, the 2012 Act makes provision for the credit union sector restructuring to be overseen and facilitated by a statutory body, ReBo, and supported by a fund (Credit Union Fund). The Central Bank is of the view that while voluntary restructuring and resolution are distinct and separate processes, both courses of action can be structured within a single framework. Thus, the Central Bank has developed a policy on Restructuring & Resolution to ensure that the voluntary restructuring of the credit union sector and the resolution framework operate in a complementary and orderly fashion and help toward achieving the aims of 1) protecting members' savings, 2) protecting sector stability, and 3) enabling sector development.

The Minister for Finance has appointed a Central Bank employee after being nominated by the Governor to the ReBo board. Accordingly, a Deputy Registrar of Credit Unions serves as a non-

¹¹ S.I. No. 533 of 2014.

voting member of ReBo. ReBo has been working extensively to facilitate and oversee voluntary restructuring cases and the Central Bank engages with ReBo and individual credit unions that see restructuring as part of their approach for delivering for their members. The overall objective of restructuring is to provide strong and sustainable credit unions that will deliver services for members in the future. While there is no target for a specific number of restructuring cases there has been a marked pick-up and momentum in restructuring activity in the last year.

In 2014, 11 transfer of engagement projects were completed involving 19 credit unions. As of 31 March 2015, the Central Bank was aware of 30 further transfer of engagement projects currently ongoing, involving 73 credit unions. To date, these transfers of engagements have not involved the use of the Credit Union Fund to provide capital support.

5. Summary of Guiding Principles

Group 1: Objectives, Independence, Powers, Transparency, and Cooperation (GUIDING PRINCIPLE 1)

GUIDING PRINCIPLE 1: Objectives, Independence, Powers, Transparency, and Cooperation

Objectives: The Central Bank is the sole authority responsible for the supervision of the credit union sector in Ireland. Under the 1997 Act, the objective of the Central Bank is to "administer the system of regulation and supervision of credit unions provided for by or under this Act with a view to (a) the protection by each credit union of the funds of its members, and (b) the maintenance of the financial stability and well-being of credit unions generally." The Central Bank's performance and exercise of its functions have been delegated to the Registrar of Credit Unions.

Independence: The Central Bank is an independent statutory body that must act in accordance with the Treaty on the Functioning of the European Union (TFEU) and the European System on Central Banks (ESCB) Statute and within the confines of the statutory regime of Irish financial services law. In certain situations the Central Bank is required to consult with (e.g. before making regulations), or in specific circumstances receive approval from, the Minister for Finance (i.e. appointment of the Registrar of Credit Unions, application of levies). There is no legislative basis upon which industry interferes in the decision-making process, although the

Central Bank consults with credit unions and credit union bodies. The Central Bank Act, 1942 also sets out the process by which the Registrar of Credit Unions may be appointed or dismissed by the Central Bank.

Powers: The Central Bank has a number of discretionary powers to address areas of weaknesses or non-compliance that have been supported by a recently enhanced regulatory framework. These include regulation making powers, including those that have been used to impose minimum prudential standards. Further changes to the 1997 Act are planned to be introduced by year-end 2015, including regulation making powers on lending, savings, investments, borrowings, liquidity, and reserves. Other powers allow the Central Bank to intervene at an early stage to require a credit union to take corrective action in respect to regulatory breaches and where there are solvency concerns. Additionally, the Central Bank has the power to enforce prudential standards by giving regulatory directions to credit unions, issuing supervisory warnings, and by taking enforcement actions under its administrative sanctions procedure.

Transparency: The Central Bank's regulatory strategy for the credit union sector is set out in the 2013-2015 Strategic Plan. Three key objectives, set out in the Strategic Plan, underpin the Central Bank's credit union sector work: 1) resolve weak and non-viable credit unions to protect members' savings and maintain financial stability within the credit union sector; 2) develop an appropriate legislative and regulatory framework to protect the stability of individual credit unions and to allow the sector to develop; and 3) bring about longer term restructuring of the sector to ensure its long-term sustainability. The Central Bank publishes the objectives contained in the Strategic Plan and the extent of their achievement in its Annual Report. Under section 18E (1)(b) of the Central Bank Act, 1942, the Central Bank shall establish an advisory group to advise the Bank, where the Bank requests, on the performance of its functions and the exercise of its powers in relation to credit unions. To date, the advisory group has not been established.

Adequate Resources: Since 2010 there has been an increase in the number of staff in RCU, which has been used to respond to the challenges being experienced by the credit union sector. In addition to allocating resources to ongoing supervision, RCU has allocated resources to the areas of restructuring (dedicated I&R team of 12 staff as of 31 March 2015) and policy development. These allocations reflect the stage of maturity of the Irish credit union sector including the significant level of regulatory change, the restructuring of the credit union sector, and the challenging operating environment for credit unions. Many Central Bank staff members were subject to pay cuts and reduced pension levels under the Financial Emergency Measures in the Public Interest Acts 2009 and 2013 (FEMPI Acts). In 2014, based on staff

leaving the Central Bank and staff transferring to other divisions in the Central Bank, staff turnover in RCU was 20%. At the time of the review there were 6 staff vacancies in RCU.

Cooperation: Governance arrangements exist to ensure cooperation and information sharing as appropriate between respective areas of the Central Bank, and the Central Bank collaborates and shares information with other domestic authorities, other supervisors and Irish authorities.

Group 2 - Licensing and Ownership (Guiding Principles 2-4)

GUIDING PRINCIPLE 2 - Permissible Activities: Permitted activities are set out in the 1997 Act and include making loans, making investments, accepting savings, and borrowing. Regulations also provide that credit unions can provide a number of additional services including internet access, third party payments, Automated Teller Machine (ATM) services, certain insurance services on an agency basis, bill payments, money transfers, standing orders, direct debits, financial counseling, and Personal Retirement Savings Accounts (PRSAs) on an introduction basis. The Central Bank may approve an application to provide additional services where there is a mutual benefit to its members and they do not impose undue risk to members' savings. The Central Bank may also approve individual credit unions to lend within longer term lending limits to those that currently apply to all credit unions in the 1997 Act.

GUIDING PRINCIPLE 3 - Licensing: The Central Bank is the sole authority with the power and responsibility for registering¹² credit unions in Ireland. Guidance has been developed, which is available to inquiring parties, on the criteria and information required to support an application. The Central Bank has the power to cancel the credit union registration if the registration was obtained by fraud. The Central Bank has not yet received a formal application for registration as a credit union since becoming the regulator of credit unions.

GUIDING PRINCIPLE 4 - Ownership: Each member shall have only one vote at an AGM or a Special General Meeting (SGM) irrespective of his or her shareholding in the credit union. Under the 1997 Act, the board of directors is required to ensure that no single person 1) is responsible for making all of the material decisions of the credit union or 2) has effective control over the business of the credit union. Also, the savings an individual member may have in a credit union is limited to the greater of €200,000 or 1% of total assets which is another measure that can help ensure that no member may exercise control by reason of the extent of their savings and the potential impact on the credit union arising from the withdrawal of these savings.

¹² Under the 1997 Act, credit unions are registered rather than licensed.

Group 3 - Prudential Regulation and Requirements (Guiding Principles 5-16)

The Central Bank has introduced a significant number of changes to the prudential regulatory framework in a relatively short period of time. While this has included extensive consultation and supporting guidance, these changes will take some time to become fully and effectively implemented and embedded under a backdrop of sector restructuring.

GUIDING PRINCIPLE 5 - Regulatory Reserves: The Central Bank has prescribed minimum regulatory reserve levels that are in line with international recommendations (WOCCU) and appropriate for the transitional state of the Irish credit union sector at this time. The sector supports the maintenance of strong reserves to ensure its long term viability, and stakeholders have indicated the need to address individual credit union circumstances of non-compliance with the minimum regulatory reserve requirement on a timely basis. Current on-site and off-site supervisory assessment and monitoring activities provide assurance that reserve requirements are met and that non-compliance issues are effectively resolved in a timely manner.

GUIDING PRINCIPLE 6 - Risk Management: An important and relevant risk management framework has been introduced for the credit union sector in Ireland, and the Central Bank has provided comprehensive guidance for credit unions on the risk management requirements. This should elevate operational and governance structures to ensure the protection of members' savings and long term viability of the sector over time with expanded business opportunities and lead to a more mature sector. Much of the current risk management framework is, however, relatively new and has been implemented with a number of other changes to the governance framework for credit unions over a relatively short period of time. These include the introduction of a risk management officer, compliance officer, and internal audit function. With this in mind, it will likely take some time for risk management practices to fully mature given the fairly comprehensive requirements outlined, especially for smaller Low and Medium Low Impact credit unions.

GUIDING PRINCIPLE 7 - Credit Risk: The Central Bank has undertaken a range of measures in relation to credit risk in credit unions. These include 1) a program of loan book reviews in 2011; 2) the introduction of lending restrictions where supervisory concerns exist in relation to weakness in governance, credit practices, and systems and controls for lending, and credit control; and 3) a program of targeted asset reviews in a number of credit unions with increased

risk profiles to determine any shortfall in their capital base. The Central Bank has also regularly updated its guidance surrounding credit risk management over a number of years. Notwithstanding the requirements outlined, the level of arrears and loan loss provisions as a percentage of the loan book has remained high over the past few years relative to international norms. While the current level of arrears partly reflects the impact of the financial and economic downturn in Ireland on the credit union sector as well as the continued fall in the sector loan-to-asset ratio, it may be an indicator of continuing weaknesses in credit underwriting practices. Further modifications to the regulatory framework are intended to strengthen credit union practices, particularly relating to lending when further revisions to the 1997 Act are introduced. The Central Bank proposes to update relevant sections of the *Credit Union Handbook* in advance of the new sections of the 1997 Act and regulations which are planned to come into effect at the end of 2015.

GUIDING PRINCIPLE 8 - Problem Assets, Provisions and Reserves: The Central Bank has focused considerable attention on this area since the financial crisis, although the risks to the sector posed by poor underwriting and inadequate provisioning had previously been identified as an issue. This prompted the issuance of guidance, such as the Guidance Note on Credit and Credit Control for Credit Unions (October 2007), references in the annual circulars to credit unions and credit union auditors that highlight the importance of ensuring the adequacy of bad debt provisions, and a program of targeted asset reviews. The post-crisis legislation has provided the Central Bank with a robust framework of powers and certain provisioning requirements have already been introduced. The Central Bank has begun the initial phase of developing a provisioning framework for credit unions. This will include informal and formal consultation with the sector, leading to a consultation paper on provisioning, intended for the end of 2015.

GUIDING PRINCIPLE 9 - Large Exposures: The current regulatory framework includes lending limits on the maximum exposure a credit union can have to a member. The Central Bank has provided guidance on credit union investments which sets out limits on exposures to specified classes of investments and single investment limits. Guidance has also been provided on policy requirements addressing lending and investment limits, connected persons, large exposures and concentration risk, including individual limits and aggregate limits on commercial lending. Supervisors use the analysis of credit union Prudential Returns as a key tool in monitoring concentration risk. Proposed regulatory changes include strengthening these requirements and adjusting limits based on regulatory capital.

GUIDING PRINCIPLE 10 - Conflicts of Interest and Related Party Exposures: This is an area to which the Central Bank has given particularly close attention because of specific characteristics of the Irish credit union sector, notably its very strong focus on community. The Central Bank has recognized that the 1997 Act provisions require some enhancement but has sought to balance changes with the sector’s characteristics, in particular by omitting earlier proposals to introduce an overall limit on related-party lending and in revising the definition of “family.” At the same time, the Central Bank has sought to enhance the governance requirements in this area and to introduce more transparency than accounting regulations alone provide. Additionally, it is proposed that in the future, the Prudential Return shall include loans to all related parties rather than to officers alone, as at present.

GUIDING PRINCIPLE 11 - Interest Rate Risk and Market Risk: The contemporary economic environment and the range of credit union business models currently employed in Ireland do not give rise to circumstances in which significant interest rate risk generally arises. The evidence is that such risk is minimal at present. In addition, the statutory and regulatory framework also prescribes an approach which minimizes the potential for the creation of interest rate risk and maximizes the likelihood of its early identification by supervisors. Should interest rate risk exist in credit unions, supervisors have appropriate, effective tools for identifying it, both by analysis of prescribed annual returns and by on-site inspections and examinations if necessary.

GUIDING PRINCIPLE 12 - Liquidity and Funding Risk: The Central Bank has prescribed credit union liquidity requirements, including the requirement to maintain a liquidity ratio of at least 20% at all times, with additional liquidity requirements where credit unions have lending over 5 years in excess of 20% of their loan book. The Central Bank reports that, as of 31 December 2014, all regulated credit unions meet the 20% minimum liquidity ratio requirement. The Report of the CCU concluded that at that time, “liquidity shortfall is not a pressing matter for most credit unions, and indeed the problem for many now appears to be one of excessive liquidity holdings” and indicated there is no compelling need for a central credit union liquidity mechanism then. This situation still pertains.

GUIDING PRINCIPLE 13 - Internal Controls: All credit unions are required to have governance arrangements that ensure effective oversight of its activities, taking account of the nature, scale and complexity of the business being conducted. Credit unions are also required to have oversight, policies, procedures, practices, systems, controls, skills, expertise and reporting arrangements in place to ensure compliance with governance requirements. Internal controls are assessed on an on-going basis where such concerns may arise through review of the external auditor’s year end management letter which may include systems and control

issues and related governance issues; issues raised in internal/external reports; and timeliness and accuracy of returns. The Central Bank has issued extensive guidance on internal controls in the Operational Risk section of the *Credit Union Handbook*.

GUIDING PRINCIPLE 14 - Abuse of Financial Services: The AMLD is a separate division in the Central Bank with specific expertise responsible for the supervision of Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) compliance by credit and financial institutions, including credit unions. The Central Bank has adopted a risk based approach to AML/CFT. Since 2010, the Central Bank has conducted and completed a number of inspections and Risk Evaluation Questionnaires (REQs) relating to AML/CFT. The completion of an REQ is a key requirement for evaluating AML/CFT risk probabilities and assessing the nature and extent of further action, including AML inspections. As part of their on-going AML/CFT Risk Assessment, supervisors determine whether credit unions have established and implemented policies and procedures to achieve compliance with their obligations under the CJA 2010. Risk assessment guidance has been developed to assist supervisors in evaluating the appropriateness of policies and procedures and practices, and compliance to AML/CFT requirements. In addition all credit unions are required to answer a number of questions on the Annual Return relating to implementation of AML/CFT requirements.

GUIDING PRINCIPLE 15 - Operational Risk: Credit unions are required to identify the operational risks that they are exposed to, or likely to be exposed to, and provide for the management and mitigation of those risks in their risk management system. Requirements exist in specific areas of operational risk, including information systems, management information, business continuity and outsourcing. In relation to information systems, credit unions are required to develop, prepare, implement and maintain secure and reliable information systems to enable the board of directors and those involved in the management of the credit union to control, direct and manage its affairs. The Central Bank has provided comprehensive guidance on all key aspects of operational risk in the Operational Risk Chapter of the *Credit Union Handbook*. It is evident, however, that IT issues are a significant and a continuing risk area in the credit union sector. Responses to recent surveys suggest that limited progress is being made to resolve identified issues in a timely manner. The modification to the supervisory engagement model in 2015 will include a focus on on-site IT assessments in certain credit unions which will likely elevate the awareness of outstanding weaknesses.

GUIDING PRINCIPLE 16 - Internal Audit: Recent changes to the 1997 Act introduced the requirement and established the independence, duties, responsibilities, and reporting requirements for an internal audit function. The Central Bank has also issued guidance in this area. Beginning in 2014, credit unions have been required to submit an annual compliance

statement which provides information on credit union compliance with certain requirements, including internal audit requirements. Central Bank supervisors review the quality of the internal audit function as part of the ongoing supervision process. During on-site engagements Central Bank supervisors meet with internal auditors to assess the independence, reporting, and overall effectiveness of the internal audit function.

Group 4 - Methods of Ongoing Supervision (Guiding Principles 17-19):

GUIDING PRINCIPLE 17 - Supervisory Access: Under the current regulatory framework, the Central Bank may compel various documents and explanations from a credit union, its officers, members, agents, liquidators, and any other persons that may be “reasonably required.” The Central Bank also has powers to request documentation from and to interview an individual as part of the Central Bank’s consideration of the individual’s fitness and probity to serve as a designated credit union official.

GUIDING PRINCIPLE 18 - Supervisory Approach, Techniques and Resources: The Central Bank’s regulatory framework is comprehensive and provides a systematic, risk-based, and well-defined regulatory approach under the PRISM engagement model. PRISM however was designed primarily for financial institutions that have a more complex business and operating model that encompasses a wide array of risks including complex lending and deposit products. Credit unions in Ireland at this time have a very basic business model. Although somewhat modified for the credit union sector, PRISM is heavily reliant on data and information, especially for developing a report following a Full Risk Assessment (FRA) for discussion and challenge by the Risk Governance Panel (RGP). However, other elements of PRISM that do not include an FRA and supporting RGP review are not as resource dependent. These include regular on-site meetings with senior management, board and committee members.

The current level of resources allocated to the RCU supervisory engagement model is only about 60% of the suggested supervisory resources. This is acknowledged in the Central Bank as a matter for longer term review. In 2015, a Temporary Supervisory Engagement Model, which moves from being driven by the existing impact basis to a probability risk focus and seeks to align with supervisory and restructuring goals, was introduced for 2015 instead of the regular PRISM engagement model. This temporary engagement model includes on-site engagement with Low Impact credit unions.

Some refinements introduced with implementation of the 2015 Temporary Supervisory Engagement Model have somewhat mitigated the effect of this resource deficit, and appear to be a very appropriate strategy given the relatively simple business model and overall size of

Irish credit unions, and the restructuring occurring within the credit union sector. Under this approach, all credit unions will be considered for a modified engagement although no FRAs or related RGPs will be undertaken, for a temporary period.

GUIDING PRINCIPLE 19 - Supervisory Reporting: The Central Bank can prescribe requirements for the format, content, and frequency of submission of required information, and can require institutions to engage external experts, for a variety of tasks, including the verification of supervisory information, where deemed necessary. The Central Bank may also require specific reports, including reports prepared and verified by independent experts, on any matters required in the performance of its duties. The Central Bank requires all credit unions to file quarterly Prudential Returns and Year End Returns, including audited accounts. Credit unions may be required to submit additional reports based on their risk profile and impact categorization. Prudential Returns may be modified as appropriate to reflect changes in the regulatory framework.

Group 5 - Accounting and Disclosure (GUIDING PRINCIPLE 20):

GUIDING PRINCIPLE 20 - Accounting and Disclosure: Accounting standards and practices are under constant review by the professional and standards bodies and the Central Bank works closely with those bodies in connection with the formulation of appropriate provisions for Irish credit unions. It also issues additional guidance, such as that provided in separate annual circulars to credit unions and to their external auditors, which are a valuable tool in drawing attention to credit union-specific accounting issues and to any current topics of particular relevance and concern. The Central Bank has also engaged directly with auditors in presentations to provide updates on changes to the regulatory framework for credit unions. In general, accounting standards are high and firmly enforced by the professional bodies. If necessary, however, the Central Bank has the power to remove the auditor of a credit union and to veto the appointment or re-appointment of an auditor of a credit union or the filling of a casual vacancy of an auditor.

Group 6 - Corrective and Remedial Powers of the Supervisory Authority (GUIDING PRINCIPLE 21):

GUIDING PRINCIPLE 21 - Corrective and Remedial Powers of the Supervisory Authority: The Central Bank has a wide range of enforcement tools available to it to facilitate timely action when, in its judgment, a credit union is not complying with laws, regulations or required actions. These include remedial actions to ensure that corrective action is undertaken

in a timely manner, particularly through the use of Risk Mitigation Programs (RMPs) and the issue of regulatory directions, and sanctions for regulatory breaches through the Central Bank's Enforcement Division. If specified conditions are met, the resolution regime prescribed by the 2011 Act allows the Central Bank to seek an appropriate order from the High Court. These powers have been used, for example, to appoint a special manager (Newbridge Credit Union), to direct a transfer (Howth Sutton Credit Union and Killorglin Credit Union) and to liquidate a credit union (Berehaven Credit Union).

Group 7 - Governance (GUIDING PRINCIPLE 22):

GUIDING PRINCIPLE 22 - Governance: A new statutory governance framework was introduced for credit unions on 11 October 2013. Additional governance requirements were introduced on 3 March 2014, completing the introduction of a comprehensive and detailed governance framework for the credit union sector. The 1997 Act now provides that a credit union should have governance arrangements that ensure there is effective oversight of its activities which take into consideration the nature, scale and complexity of the business being conducted by the credit union. Requirements also include establishing clearly defined roles and responsibilities; performance management, succession planning and remuneration policies; a strategic plan; a risk management system; an internal audit function; an annual compliance statement; and a BOC. In addition, the Central Bank has introduced Fitness and Probity Standards for designated functions, including the manager, chair, directors and management which was introduced on 1 August 2013 for credit unions with total assets greater than €10m, will apply to all credit unions on 1 August 2015, and be fully implemented for all credit unions in 2016. The Central Bank has provided comprehensive guidance on all these new requirements.

Group 8 - Major Acquisitions (GUIDING PRINCIPLE 23):

GUIDING PRINCIPLE 23 - Major Acquisitions: The Central Bank ensures that any transfer of engagements would not expose the credit union or members' funds to undue risks or hinder effective supervision in the future. This includes an assessment of areas of potential risk, including an assessment of the combined entity's ability to comply with regulatory requirements and the proposed governance structure. The transfer of engagement process, including assessment criteria and supporting documentation and requirements, generally applies to all credit unions regardless of size, which may impact current restructuring efforts in particular cases where the transferring credit union has significantly smaller assets than the transferee credit union. Using the existing structure, the time period for transfers of engagements varies, typically ranging from 6 to 9 months from initiation to completion.

Timeframes can also be impacted by other factors, including the credit unions' own timelines and plans and the nature and complexity of issues in the credit unions involved.

6. Recommended Actions to Improve Effectiveness of Compliance

A. Supervisory Approach

- Supervisory Approach: PRISM, the Central Bank's risk based supervisory framework, has been applied to credit unions since 2012. In view of the need for and value of on-site engagement and given that the Central Bank resources allocated to supervisory engagement under PRISM are approximately 60% of the level of PRISM suggested supervisory resources, we recommend that the RCU should consider the way in which its PRISM framework is most effectively employed by the RCU. Although modified for the credit union sector, PRISM is heavily reliant on off-site risk assessment, analysis and review. Refinements introduced with implementation of the 2015 Temporary Supervisory Engagement Model have somewhat mitigated the effect of the resource shortfall. These refinements include engagement with Low Impact credit unions and actually appear to be a very appropriate strategy for 2015 given the low level of complexity of the business model, overall size of Irish credit unions and the current context of the Irish credit union sector, including the embedding of the new regulatory framework and the restructuring of the credit union sector currently underway. The Central Bank may also wish to consider embedding some or all of these 2015 refinements into the longer-term supervisory engagement model on an on-going basis. This could include more streamlined off-site processes, scaled back documentation, reporting and review requirements commensurate with the scale and complexity of the credit union, and more regular on-site engagements with appropriate minimum levels of testing and sampling in critical key risk areas in all credit unions. (Guiding Principle 18)
- Credit Risk: The Central Bank should consider focusing its attention on key risks, particularly the lending area of credit risk, that have real potential to cause material damages to credit unions and impact longer term viability. Under PRISM, the frequency and extent of on-site supervision activities for credit risk may not allow for sufficient oversight of this key risk area. The Central Bank has indicated that weak lending policies and underwriting standards remain a key concern. Under the Temporary Engagement Model introduced for 2015, Low

Impact and certain other weaker credit unions will be subject to a risk focused on-site engagement, which will include an assessment of the extent or otherwise of risks posed in terms of viability, potential weakness and/or absence of key policies. Where appropriate, this will include consideration of credit risk policies and practices. RCU has indicated that it is to develop a longer term engagement model for credit unions in 2015 to apply thereafter. Given the inherent risks and continuing high levels of loan arrears as a percentage of total loans, we welcome RCU's intention to refine the longer term engagement model in the future. We recommend this should always include a full on-site review of credit risk for all credit unions, including Low Impact credit unions, and a minimum appropriate level of sampling and testing of actual lending and investment practices. (Guiding Principle 7)

- Credit Risk: The Central Bank has recently commenced a review of lending restrictions in the credit union sector; lessons may be learned from this and applied to the longer term engagement model that is currently being developed. It may also wish to consider further refining the approach for lending restrictions to see if these could be applied more rigorously to higher risk credit unions, especially where material outstanding weaknesses and deficiencies persist. This may include restrictions on specific lending, including loan rescheduling and further reductions in lending limits. (Guiding Principle 7)
- Operational Risk: The Central Bank may wish to concentrate its further review of IT risks on those credit unions with more complex products and services, or that seek to expand existing services, and where material higher risk issues exist in this space. (Guiding Principle 15)
- Supervisory Approach: Since 2012, approximately 3,500 risk issues have been identified and communicated to credit unions along with the RMP actions required to be taken by the credit union to address. Where possible, RMPs should concentrate on material risk issues that need to be addressed as a matter of urgency while recording other outstanding weaknesses that will need to be addressed over time. For example, RMPs for material issues would have specific actions and timelines set out by the supervisor. Other less critical deficiencies could be individually listed for credit unions to acknowledge, develop and approve appropriate action plans and timelines for supervisory follow up as part of an on-site review engagement. (Guiding Principle 18)
- Abuse of Financial Services: At the present time there are only a limited number of planned AML/CFT inspections for 2015 although the number could increase on a reactive basis as a result of identified material issues. While it is recognized that the Central Bank's approach is risk based, and has excluded Low Impact credit unions, the level of planned engagement

does not seem sufficient given the issues noted in the Central Bank's "Dear CEO" letter published in October 2012. The Central Bank may wish to consider implementing a minimum level of on-site review of key aspects of a credit union's practices. (Guiding Principle 14)

- Major Acquisitions: The transfer of engagements process, including assessment criteria and supporting documentation and requirements generally applies to all credit unions regardless of size. This is a fairly comprehensive and time consuming process for the credit unions and the Central Bank/ReBo which may inhibit restructuring efforts. During the current restructuring phase of the Irish credit union sector, the Central Bank may wish to consider modifying the assessment process and criteria where appropriate. For example, a more streamlined process may be appropriate for transfer of engagements between larger and smaller credit unions where the assets of the transferor credit union(s) are significantly lower than the assets of the transferee credit union and where there are no material outstanding risk issues of the transferee. (Guiding Principle 23)

B. Communication and Guidance

- Risk Management/Governance: A new comprehensive risk management and governance framework for all credit unions, which introduced a number of new requirements and functions, has only recently been introduced over a relatively short timeframe. While the Central Bank has engaged with the sector on all recent changes and introduced extensive guidance on the new requirements, it is apparent that these changes are not yet fully understood by the credit union sector and will likely take some time to be effectively implemented. Given the extent of the regulatory changes, the Central Bank should consider expanding its on-site engagements with credit unions to foster greater awareness and understanding of key requirements, formulate expectations and help ensure that any material weaknesses can be appropriately addressed within a suitable timeframe. (Guiding Principle 6, Guiding Principle 22)
- Risk Management/Governance: The Central Bank may also wish to work with the credit union sector in developing sample tools and/or best practices to supplement their risk management and governance guidance that may help smaller credit unions, in particular to more readily implement suitably scaled approaches. (Guiding Principle 6, Guiding Principle 22)

- Credit Risk: Current lending and investment sections of the *Credit Union Handbook* make reference to a number of previously issued publications and guidance. The Central Bank proposes to update relevant sections of the *Credit Union Handbook* in advance of the new sections of the 1997 Act and new regulations which are planned to come into effect at the end of 2015. It may be helpful at that stage to fully consolidate all current lending and investment guidance into separate reference documents that are more functional and cohesive. (Guiding Principle 7)
- Problem Assets, Provisions and Reserves/Accounting and Disclosure: The Central Bank has undertaken important supervisory work in establishing the true state of credit union loan books, through asset reviews and PRISM on-site engagements in selected credit unions, and in laying the foundations for higher-quality, disciplined, lending. It also provides useful, practical, guidance to credit unions and audit firms regarding the correct approaches to be taken to provisioning and the prudent management of non-performing or impaired loans. In view of the key importance of the latter issue, we recommend that the Central Bank maintains and, if possible, increases its focus on providing guidance and education to the sector in these areas. (Guiding Principle 8, Guiding Principle 20)
- Abuse of Financial Services: The Central Bank may wish to consider requiring all credit unions to submit a more detailed annual questionnaire in order to maintain on-going awareness of AML/CFT requirements. This could help to identify their progress, or required assistance, for implementing effective AML/CFT practices, including the extent of, and plans to satisfy, training requirements. A completion guide, especially for smaller credit unions setting out examples of expectations, may help increase its effectiveness in the development of appropriate on-going processes and practices. (Guiding Principle 14)
- Supervisory Approach: In order to assist credit unions in their understanding of the process, the Central Bank may wish to consider publishing an overview of its approach for on-site engagements including key considerations that supervisors use when assessing the adequacy of risk management and governance practices, strategic planning and viability and for determining material weaknesses. (Guiding Principle 18)
- Major Acquisitions: The ReBo Merger Handbook which sets out details on the process is a useful document for credit unions. It may be helpful to retain its structure, suitably modified and published as a Central Bank document, after the Minister for Finance dissolves ReBo when he is satisfied that, following a review, ReBo has completed the performance of its functions. (Guiding Principle 23)

- Objectives, Independence, Powers: Given the establishment of the Commission on Credit Unions (May 2011-March 2012) and the Commission on Credit Unions Implementation Group (May 2012-May 2014), an advisory group for credit unions has not been established to date. It may be appropriate to consider the timeframe and arrangements for the establishment of a Credit Union Advisory Group as provided for in the Central Bank Act, 1942. (Guiding Principle 1)
- Objectives, Independence, Powers: We also suggest that consideration be given by the relevant authority to directing a closely-defined, limited, review to evaluate the implementation of the original recommendations of the CCU and to propose any revisions or measures thought necessary in light of that experience. Such a review could possibly be undertaken by the CUAC, if permissible under its Terms of Reference, with whom we met, as part of its important work in maintaining the impetus stemming from the CCU's Report. We accept that this is not itself a matter for the Central Bank, but simply note that we think such an exercise might prove valuable for both the Central Bank and for Irish credit unions in general. (Guiding Principle 1)

C. Resourcing

- Objective, Independence, Powers/Supervisory Approach: Having undertaken the demanding task of introducing a comprehensive regulatory structure for credit unions, of gaining a sound understanding of the true health of the sector, and bringing about essential restructuring, the Central Bank should consider refocusing its attention, and scarce resources, on key risks, particularly credit risk, that have real potential to cause material damage to its objectives. Poor-quality underwriting and a failure to understand and apply the principles of sound lending have been, and remain, significant problems for many Irish credit unions. Achieving a permanent improvement in those areas will take considerable time and will not be achieved without continued focus and attention across the sector by the Central Bank.

RCU needs to ensure that it has the adequate level of resources necessary to deliver on all aspects of its regulatory strategy. The required level of resources will also need to take into account any additional resourcing requirements arising from the recommendations contained above in relation to "Supervisory Approach" and "Communications and Guidance." (Guiding Principle 1, Guiding Principle 18)

7. Central Bank's Response

The Central Bank wishes to express its appreciation to the ICURN credit union peer review team (ICURN team) for their detailed assessment of the Central Bank's compliance with the ICURN peer review criteria which are set out in the "Central Bank of Ireland Peer Review Report - Central Bank Performance of its Regulatory Functions in Relation to Credit Unions" (the peer review report). The ICURN peer review criteria are primarily based on the [ICURN Guiding Principles of Effective Supervision for Cooperative Financial Institutions](#) and the Central Bank recognises ICURN's valuable work in the development of these principles.

In line with its statutory mandate, the Central Bank is committed to ensuring the protection of members' savings by credit unions and the financial stability of the credit union sector overall. The Central Bank acknowledges and welcomes the ICURN teams' recommendations on areas for potential enhancement in the Central Bank's performance of these functions.

The Central Bank welcomes the ICURN team's recognition that the Central Bank effectively performs its functions in the regulation and supervision of the credit union sector and that the Central Bank has effectively undertaken the demanding task of introducing a comprehensive regulatory structure for credit unions. The Central Bank also notes the ICURN team's recognition that the Central Bank's supervisory practices were commensurate with the complexity, size, and risk profile of the credit union sector and the individual credit unions supervised.

The Central Bank's participation in the credit union peer review represented an opportunity for us to invite external scrutiny on the performance of our functions in relation to credit unions for the purposes of ensuring that we measure up to international standards and the expectations of sector stakeholders. In view of the substantial changes in the regulatory regime and operating environment for credit unions in Ireland that have been ongoing since 2012 including:

- (i) the introduction of a risk based supervisory framework (PRISM);
- (ii) the introduction of a strengthened regulatory framework for credit unions; and
- (iii) the voluntary restructuring of the credit union sector that is currently underway,

the peer review report provides a timely examination of Ireland's legislative, regulatory and supervisory framework in relation to credit unions.

A. Overall Comments on ICURN Team's Recommendations

The Central Bank is generally in agreement with the findings contained in the peer review report and will consider in detail how we may implement and enhance our current practices in the areas referred to in the ICURN team's recommendations.

Credit unions have been present in Ireland for over 50 years and play an important role, at both community and society level, in the Irish financial services landscape. The significant level of regulatory change, the restructuring of the credit union sector and the challenging operating environment for credit unions are unique features of the Irish credit union sector in comparison to credit union sectors in other jurisdictions at this time. Against this background, prudent development, growth and restructuring are crucial to ensure that the credit union sector remains viable and sustainable and continues to play a substantial role in providing lending and deposit-taking opportunities in local communities and society. This challenging and evolving environment for credit unions will also be taken into account by the Central Bank when identifying any enhancements to be made to our supervisory and regulatory approach.

The Central Bank has the following comments in relation to the Key Recommendations made by the ICURN team in the peer review report.

B. Supervisory Approach

We note the ICURN team's recommendations in relation to the PRISM supervisory engagement model which suggests that the Central Bank consider the way in which the PRISM framework is most effectively employed by RCU including:

- embedding some or all of the refinements in the 2015 Temporary Supervisory Engagement Model, such as engagement with Low Impact credit unions, in the supervisory engagement model on an ongoing basis;
- focusing attention on key risks, particularly the lending area; and
- giving consideration to more streamlined off-site processes and more regular on-site engagements.

The Central Bank welcomes the ICURN team's finding that PRISM has proved to be an effective and valuable tool in the short term, in particular the refinements to PRISM introduced on a temporary basis for 2015. PRISM is a risk based supervisory framework that applies to all

regulated entities and a tailored version of PRISM was introduced for credit unions in 2012. The PRISM supervisory engagement model for credit unions has been evolving since 2012 to take account of the changing context of the credit union sector.

We are currently developing a longer term supervisory engagement approach for credit unions that will take account of the current context of the credit union sector and the experience gained from the 2015 and previous supervisory engagement models. This longer term supervisory engagement approach is being developed to support RCU's regulatory strategy for credit unions including: the achievement of appropriate standards in the credit union sector; ensuring the protection of members' savings by credit unions; and providing a focus on viability, restructuring and development. The longer term supervisory engagement approach will provide the Central Bank with an opportunity to ensure an emphasis within PRISM on the main risk categories which are particularly relevant for the credit union sector and to consider the appropriate level of on-site engagement and off-site processes.

C. Communications and Guidance

We welcome the ICURN team's acknowledgement of the work undertaken by the Central Bank to date in developing communications and guidance for the sector for the implementation of the new regulatory framework and welcome the recommendations for enhancements in this area. We agree that communication and engagement with the credit union sector is a key part of the Central Bank's relationship with the sector to support the achievement of appropriate standards, in particular to ensure the implementation of the new regulatory requirements and clarity for credit unions on the Central Bank's expectations in this regard. As part of the development of our longer term supervisory engagement approach we will identify how best to implement the ICURN team's recommendations in this area, in particular the recommendations on expanding on-site engagements to foster greater understanding in credit unions of key requirements and the Central Bank's expectations.

In relation to the recommendation on the establishment of a credit union advisory group, the Commission on Credit Unions (CCU) was in place from May 2011 to March 2012 and the Commission on Credit Unions Implementation Group (CIG) was in place from May 2012 to May 2014. The establishment of the CCU and the CIG influenced the Central Bank in its decision to await completion of this work before establishing an advisory group for credit unions. Given that both the CCU and CIG have now concluded their work the Central Bank will consider the establishment of an advisory group, as provided for in the Central Bank Act, 1942, to advise the Central Bank, where the Central Bank so requests, on the performance of its functions in relation to credit unions.

While not a recommendation for the Central Bank, we note the ICURN team's recommendation that consideration be given by the relevant authority to directing a closely-defined, limited review to evaluate the implementation of the original recommendations of the CCU and we would welcome the opportunity to participate in and contribute to any such review that may be undertaken.

D. Resourcing

We are aware of and acknowledge the ongoing challenge we face in relation to the allocation of resources and ensuring that RCU has adequate resources to deliver on all aspects of its regulatory strategy. We support the ICURN team's recommendations in this area and we note the potential resource implications that arise. As part of the regular Central Bank manpower planning exercise which will be conducted in RCU in 2015 and subsequent years, we will continue to assess resources required for each of the areas of work that support delivery of RCU's mandate, namely:

- on-site engagement for all credit unions and off-site support, guidance, review and analysis to support the achievement of appropriate standards in the sector;
- restructuring of the credit union sector; and
- facilitating the prudent and sustainable development of the sector.

The manpower planning for 2016-2018 for ongoing supervision will be based on the longer term supervisory engagement approach that is currently being developed and will be informed by the experience from the 2015 Temporary Supervisory Engagement Model, the earlier PRISM-based approach and the emerging shape of a restructured credit union sector. An assessment of the ICURN team's recommendations will also be undertaken as part of this manpower planning.

E. Specific Comments on ICURN Team's Findings and Ratings

The Central Bank has the following comments in relation to the three Guiding Principles which were rated as "Largely Compliant."

Guiding Principle 7 – Credit Risk

The Central Bank agrees that credit risk is a key risk area for credit unions and, as acknowledged by the ICURN team, the Central Bank has and continues to focus on credit risk in credit unions through regular updates to its guidance surrounding credit risk management and a range of

supervisory measures. These supervisory measures include a programme of targeted assets reviews as well as the application of lending restrictions in individual credit unions where considered necessary.

We note the ICURN team's recommendation that the supervisory engagement model should always include an on-site assessment of credit risk, including a minimum appropriate level of sampling, and we will consider this recommendation during the development of the longer term supervisory engagement approach.

In relation to lending restrictions, we commenced a lending restriction review programme in February 2015 to invite credit unions that had made the necessary improvements in their lending practices to apply for a review of their lending restriction. Following completion of this review programme we will assess any amendments to be made to the overall approach for lending restrictions. This assessment will take account of the ICURN team's recommendation to consider whether lending restrictions could be applied more rigorously to higher risk credit unions. The assessment will also consider the extent to which lending restrictions continue to be used as a regulatory tool in the future following the introduction of the new lending regulations which are planned to come into effect from the end of 2015.

In line with the ICURN team's recommendation on lending and investment guidance, we will be reviewing and updating certain chapters of the Credit Union Handbook, including the Lending and Investment Chapters, later this year following finalisation of the new regulations recently consulted on in CP88. We have indicated in CP88 that the updated chapters will include consolidated and cohesive guidance that will incorporate previously issued Guidance Notes, circulars and any additional guidance in one place. In addition to updating the Credit Union Handbook, we are reviewing our structures and approach generally to better support effective outcomes from our on-site engagement and this will involve more supervisory guidance materials to support consistency in approach and ensure appropriate proportionality in on-site visits, reports and actions arising.

Guiding Principle 14 – Abuse of Financial Services

We note the ICURN team's recommendation that a minimum level of on-site review of key aspects of a credit union's AML/CFT practices is undertaken in all credit unions. While the Central Bank acknowledges that only a limited number of credit union inspections have been planned for 2015, it should be noted that the majority of the inspections and all of the AML/CFT Risk Evaluation Questionnaires completed to date, were delivered in 2013 and 2014. The Central Bank believes that this provided significant coverage in a two year period. On the basis

of this supervisory activity, the Central Bank has developed a clear view of where the AML/CFT issues lie within the sector.

The Central Bank's recently published '[Report on Anti-Money Laundering/Countering the Financing of Terrorism and Financial Sanctions Compliance in the Irish Credit Union Sector](#)' will provide credit unions with further guidance as to the measures they need to take in order to comply with the legislation and strengthen their AML/CFT Frameworks. In addition to this, confirmation will be required by all credit unions in their 2016 Annual Return, and subsequent returns, that they have implemented appropriate measures, according to the nature, scale and complexity of their business, to address the expectations of the Central Bank as set out in the report. This will provide the Central Bank with additional quantitative and qualitative data to supplement any findings from the planned 2015 inspections.

We also note the ICURN team's recommendations that consideration be given to requiring credit unions to submit a more detailed annual questionnaire in order to maintain on-going awareness of AML/CFT requirements and that a completion guide setting out examples of the Central Bank's expectations may help increase effectiveness in the development of on-going processes and practices in credit unions. As referred to above:

- the Central Bank has now published a detailed report specifically for the credit union sector (21 May 2015) a copy of which has been issued directly to all credit unions; and
- we are also making amendments to the Credit Union Annual Return to facilitate credit unions in confirming that they have read this report and implemented appropriate measures, according to the nature, scale and complexity of their business, to address the expectations of the Central Bank as set out in the report. It will be possible to draw Management Information from the Annual Return which will assist the Central Bank in identifying any areas of concern.

It should also be noted that where credit unions' AML/CFT practices are found to be deficient, the Central Bank takes regulatory action as necessary to ensure credit unions improve the relevant practices. In 2012 the Central Bank took an Enforcement Action against a credit union under its administrative sanctions procedure for breaches of requirements of the CJA 2010 which related to failures in the credit union's AML systems and controls. The Enforcement Action resulted in a reprimand and monetary penalty for the credit union.

The Central Bank is of the view that the measures outlined above address the ICURN team's recommendations on Guiding Principle 14.

Guiding Principle 18 – Supervisory Approach, Technique and Resources

A number of the recommendations on GP18 have been discussed in the 'Supervisory Approach' and 'Resourcing' sections above. The Central Bank is actively considering, in the context of the

development of its longer term supervisory engagement approach, how best to implement these recommendations.

The Central Bank notes the ICURN team's recommendation that RMPs issued by the Central Bank should focus on material risk issues and that credit unions should acknowledge and develop actions plans for less critical issues. While the Central Bank is of the view that RMPs issued to credit unions generally do focus on the most significant risk issues, this recommendation will be considered during the development of the longer term supervisory engagement approach.

F. Concluding Comments

The Central Bank recognises the importance and benefits of an external review of its regulatory performance in relation to credit unions. We welcome the recommendations in the context of continuously improving our regulatory framework and supervisory practices for credit unions and remain strongly committed to doing so.

The Central Bank will evaluate and consider all of the recommendations made by the ICURN team to enhance the Central Bank's practices, in the context of ICURN team's recognition of the Central Bank's supervisory practices being commensurate with the Irish credit union sector and their acknowledgement of the scale and scope of the task undertaken by the Central Bank to date.

8. Summary Assessment (including Rating)

The ICURN Credit Union Peer Review's assessment used five grading categories for each Guiding Principle having regard to the International Monetary Fund (IMF) grading categories used for assessment of regulatory compliance with *Basel Core Principles for Effective Banking Supervision*. In assessing each Guiding Principle, the ICURN team used their own methodology when considering the criteria as set out here. The assessments were based on the ICURN team's review and judgment of the information it received prior to and during the on-site engagement. These ratings are not in any way to be taken or held out as assessments based on the IMF methodology.

Following are the grading categories and criteria used in the observation of the Guiding Principles.

Grade	Criteria
Compliant	An assessment of "compliant" is given when all criteria are met without any significant deficiencies, including instances where the Principle has been achieved by other means.
Largely Compliant	A "largely compliant" assessment is given when there are only minor shortcomings, which do not raise serious concerns about the authority's ability to achieve the objective of the Principle and where there is clear intent to achieve full compliance with the Principle within a prescribed period of time (for instance, the regulatory framework is agreed but has not yet been fully implemented).
Materially Noncompliant	A Principle is considered to be "materially noncompliant" in case of severe shortcomings, despite the existence of formal rules and procedures and there is evidence that supervision has clearly not been effective, the practical implementation is weak or that the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance.
Noncompliant	A Principle is assessed "noncompliant" if it is not substantially implemented, several criteria are not complied with, or supervision is manifestly ineffective.
Non-applicable	A category of "non-applicable" is reserved for those cases that the criteria would not relate to the country's circumstances. In addition, a Principle would be considered not applicable when, in the view of the assessor, the Principle does not apply given the structural, legal and institutional features of a country.

GUIDING PRINCIPLE	RATING	COMMENTS
1. Objectives, Independence, Powers, Transparency, and Cooperation	C	The Central Bank is the sole independent regulatory authority for the Irish credit union sector. Its objectives include supervising and regulating credit unions with a view to ensuring the protection of members' funds by credit unions and the financial stability and well-being of credit unions generally. An advisory group in relation to credit unions has not been established to date as provided by section 18E of the Central Bank Act, 1942. The Central Bank has a number of discretionary powers to address areas of weaknesses or non-compliance. Governance arrangements exist to ensure cooperation and information sharing as appropriate. The Central Bank's performance and exercise of its functions in relation to credit unions has been delegated to the Registrar of Credit Unions. RCU's 2015 approved staffing level is below the level necessary to carry out all supervisory activities in line with PRISM as well as RCU's other strategic objectives in the areas of restructuring and the strengthened regulatory framework. However, while the 2015 approved staff complement for RCU presents significant challenges for RCU, RCU has tailored its approach to ensure focus on delivering key strategic priorities. At the time of the review, RCU was also operating below its 2015 approved staff complement level.
2. Permissible Activities	C	No further comments.
3. Licensing	C	The Central Bank has developed registration criteria and established internal processes.
4. Ownership	C	No further comments.
5. Capital Adequacy	C	Current supervisory assessment and monitoring activities provide assurance that reserve requirements are met and that non-compliance issues are effectively resolved in a timely manner.

GUIDING PRINCIPLE	RATING	COMMENTS
6. Risk Management	C	Much of the current risk management framework is relatively new and has been implemented over a relatively short period of time. With this in mind, it will likely take some time for risk management practices to fully mature given the fairly comprehensive requirements outlined, especially for smaller Low and Medium Low Impact credit unions.
7. Credit Risk	LC	Credit underwriting practices remain weak notwithstanding recent regulatory changes, supporting guidance and loan book reviews. Further modifications to the regulatory framework are intended to strengthen credit union practices, particularly relating to lending when further revisions to 1997 Act are introduced at the end of 2015 along with new regulations. Given the inherent risks and continuing high levels of loan arrears, more frequent sector wide on-going on-site assessment of lending practices will help enhance the effectiveness of supervisory practices.
8. Problem Assets, Provisions and Reserves	C	The Central Bank has begun the initial phase of developing a provisioning framework for credit unions which will provide the adoption of for a more consistent and conservative approach intended to be issued for consultation by the end of 2015.
9. Large Exposures	C	The Central Bank treats concentration risk with great caution. Historically, it has resulted in a number of adverse outcomes in individual cases, and the sector is now thought to be very risk-averse. The Central Bank has proposed changes in CP88 to the regulatory framework to better address this risk.
10. Conflicts of Interest and Related Party Exposures	C	The Central Bank has sought to enhance the governance requirements in this area and to introduce more transparency than accounting regulations alone provide. Prudential Returns are being amended to include loans to all related parties rather than to Officers alone, as at present.

GUIDING PRINCIPLE	RATING	COMMENTS
11. Interest Rate Risk and Market Risk	C	The evidence suggests that risk in these areas is minimal at present.
12. Liquidity and Funding Risk	C	No further comments.
13. Internal Controls	C	Requirements have been introduced for credit unions in relation to managing operational risk and ensuring that they have systems and controls in place. The Central Bank has also issued extensive guidance on internal controls and assesses internal controls on an on-going basis.
14. Abuse of Financial Services	LC	While all credit unions are required to answer a number of questions on the Annual Return, the level of engagement noted does not seem sufficient given the issues noted in the Central Bank's 'Dear CEO' letter issued in October 2012. There are only a limited number of planned inspections for 2015 although the number could increase on a reactive basis as a result of identified material issues. The effectiveness of supervisory practices will be enhanced by raising awareness of AML/CFT requirements through increased communication, guidance and on-site engagements.
15. Operational Risk	C	The Central Bank has indicated that IT issues are a significant and continuing risk area in the credit union sector. Modification to the supervisory engagement model in 2015 and an increase in on-site IT assessments, where warranted, are expected to raise awareness of outstanding weaknesses and help address any material weaknesses through the RMP process.
16. Internal Audit	C	No further comments.
17. Supervisory Access	C	No further comments.

GUIDING PRINCIPLE	RATING	COMMENTS
18. Supervisory Approach, Techniques, and Resources	LC	The Central Bank uses the PRISM engagement model which was primarily designed for financial institutions with more complex business and operating models. Refinements introduced in 2015 appear to be a very appropriate strategy and more effective at the present time given the relatively simple business model and overall size of Irish credit unions, and the restructuring occurring within the credit union sector. Further refinements including increased on-site engagements, on-going testing of key risk practices and increased dialogue with credit unions will help enhance supervisory practices.
19. Supervisory Reporting	C	No further comments.
20. Accounting and Disclosure	C	The Central Bank considers the area of accounting and disclosure as being crucially important to the stability and reputation of the sector as a whole. The laws and regulations that apply directly to credit unions are complemented by a number of important statutory provisions regarding the responsibilities of auditors and the standards expected of them.
21. Corrective and Remedial Powers of the Supervisory Authority	C	The Central Bank has a wide range of enforcement tools available to it to facilitate timely action when, in its judgement, a credit union is not complying with laws, regulations or required actions.
22. Governance	C	A number of new regulatory requirements have been recently introduced completing the introduction of a comprehensive and detailed governance framework for the credit union sector.
23. Major Acquisitions	C	The Central Bank has developed assessment criteria and processes to ensure that any transfer of engagements would not expose the credit union to undue risks or hinder effective supervision in the future.

Table 8.1 Summary of Assessment Ratings

Compliant	20
Largely Compliant	3
Materially Noncompliant	0
Noncompliant	0
Non-applicable	0
Total	23

9. Detailed Assessment

GUIDING PRINCIPLE 1: OBJECTIVES, INDEPENDENCE, POWERS, TRANSPARENCY, AND COOPERATION

An effective system of supervision will have clear responsibilities and objectives defined for each authority involved in the supervision of the industry. It is essential for each authority to have operational independence, transparent processes, sound governance and adequate resources and for it to be accountable in its discharge of duties. An effective legal framework is also necessary, including the powers for authorization, supervision, powers to enforce compliance with relevant laws, safety and soundness and legal protection for supervisors. Where relevant, authorities must have the legal capacity to share information while protecting the confidentiality of information.

GUIDING PRINCIPLE 1.1. The responsibilities and objectives of each of the authorities involved in credit union supervision are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the credit union sector, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.

Description and Findings – GUIDING PRINCIPLE 1.1: A single competent authority is responsible for credit union supervision, namely the Central Bank, whose overall responsibilities are largely defined in section 6A(2)(b) of the Central Bank Act, 1942, and are publicly disclosed. The Central Bank is an independent statutory body that must act in accordance with TFEU and the ESCB Statute and within the confines of the statutory regime of Irish financial services law. The Central Bank is also a competent authority under the CJA 2010 for supervision and compliance by credit and financial institutions, including credit unions.

Some of the Central Bank's objectives, as provided by the Central Bank Act, 1942, include the stability of the financial system overall, and the proper and effective regulation of financial institutions and markets, while ensuring that the best interests of consumers of financial services are protected. The responsibilities and objectives of the Central Bank are published in the Central Bank's Annual Report and Strategic Plan.

The 1997 Act clearly sets out the framework for credit union registration, regulation, supervision, and operation. Under section 84 of the 1997 Act, the Central Bank has the objective to "administer the system of regulation and supervision of credit unions provided for by or under this Act with a view to (a) the protection by each credit union of the funds of its members, and (b) the maintenance of the financial stability and well-being of credit unions generally."

The performance and exercise of the functions and powers of the Central Bank under the 1997 Act have been delegated to the Registrar of Credit Unions under section 33AA of the Central Bank Act, 1942.

GUIDING PRINCIPLE 1.2. Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for credit unions. The supervisor has the power to increase the prudential requirements for credit unions based on their risk profile and systemic importance.

Description and Findings – GUIDING PRINCIPLE 1.2: Minimum prudential standards are set through legislation and regulations. The 1997 Act provides the Central Bank with certain regulation making powers including powers that have been used to impose minimum prudential standards on liquidity and reserves (S.I. No. 344 of 2009 and S.I. No. 515 of 2010). The Central Bank (Supervision and Enforcement) Act 2013 has also enhanced the powers of the Central Bank to make regulations (section 48). Section 87 of the 1997 Act and section 45 of the Central Bank (Supervision and Enforcement) Act 2013 provides the Central Bank with the power to give regulatory directions to credit unions. When the remaining provisions of the 2012 Act are commenced, the 2012 Act will amend the 1997 Act by replacing provisions of prudential standards that are currently in primary legislation with regulation making powers for the Central Bank, including regulation making powers on lending, savings, investments, borrowings, liquidity, and reserves. At that time, the Central Bank will have increased flexibility to set minimum prudential standards for credit unions and to increase the prudential standards for the credit union sector if required.

The Central Bank may require a credit union to implement an RMP. The Central Bank has the power, for more serious issues, to enforce prudential standards by giving regulatory directions to credit unions, issuing supervisory warnings and taking enforcement actions under its administrative sanctions procedure.

GUIDING PRINCIPLE 1.3. When, in a supervisor’s judgment, a credit union is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the credit union or the credit union sector, the supervisor has the power to: (a) take (and/or require a credit union to take) timely corrective action; (b) impose a range of sanctions; (c) revoke the credit union’s registration; and (d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the credit union, including triggering resolution where appropriate.

Description and Findings – GUIDING PRINCIPLE 1.3: The Central Bank has broad powers to address regulatory breaches by credit unions and practices and actions which prejudice the interest of members. The supervisory measures include statutory powers and non-statutory means to allow the Central Bank to intervene at an early stage to require a credit union to take corrective action in respect to regulatory breaches and, in particular, where there are concerns as to its solvency.

The 1997 Act (section 87) and the Central Bank (Supervision and Enforcement) Act 2013 (section 45) provide that the Central Bank may give regulatory directions to a credit union in certain circumstances, including if the credit union has failed to comply with the requirements imposed under financial services legislation; has become unable to meet its obligations to its creditors or its members; or is not maintaining adequate capital resources.

When a credit union is not complying with laws and regulations, there is competent authority for the RCU to give regulatory directions requiring a credit union to take correction actions to address the situation. RCU may also require a credit union to provide a written statement outlining the steps it will take to comply with any regulatory direction imposed. Further, appropriate authority exists for the credit union's registration to be revoked or cancelled.

Since 1 August 2013¹³ the Central Bank has the power to administer sanctions under the administrative sanctions procedure for breaches by credit unions and persons concerned in the

¹³ Information provided by Central Bank. Prior to 1 August 2013, the administrative sanctions procedure only applied to credit unions in respect to prescribed contraventions of Anti-Money Laundering and Payments Services legislation. An administrative sanctions procedure was taken in respect to breaches of anti-money laundering legislation in 2011. See Guiding Principle 14 for further detail.

management of credit unions of obligations under financial services legislation, codes, or regulatory directions, known as "prescribed contraventions." Such sanctions that may be imposed include caution or reprimand; direction to refund or withhold all or part of an amount of money charged or paid for the provision of a financial services; monetary penalty; among others.

The Central Bank and Credit Institution (Resolutions) Act 2011 established an effective resolution regime for dealing with failing credit institutions including credit unions. If specified intervention conditions are met, the resolution regime allows the Central Bank to take certain actions, including the following, which are subject to High Court approval: 1) make an order to transfer the assets and liabilities of a credit union to a third party; and 2) make an order imposing a special manager regime on credit unions. The Central Bank may also petition the High Court to wind up a failing credit union. Further powers granted provide that the Central Bank may require a credit union to prepare and implement a recovery plan and permit the Central Bank to prepare and implement a resolution plan.

RCU collaborates with a number of relevant authorities in relation to resolution actions, including the Central Bank's SRU, the Minister for Finance, the Central Bank's Payments and Securities Settlements Division (PSSD), and ReBo. As appropriate, a Memorandum of Understanding (MOU) exists between RCU and SRU.

GUIDING PRINCIPLE 1.4. The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on credit unions under its supervision.

Description and Findings – GUIDING PRINCIPLE 1.4: The Central Bank is an independent statutory body that must act in accordance with TFEU and the ESCB Statute and within the confines of the statutory regime of Irish financial services law. In certain situations the Central Bank is required to consult with (e.g. before making regulations) or in specific circumstances receive approval from, the Minister for Finance (i.e. appointment of the Registrar of Credit Unions, application of levies). There is no legislative basis upon which industry interferes in the decision-making process, although the Central Bank consults with credit unions and credit union bodies.

Although under the 2012 Act, ReBo is mandated to facilitate and oversee restructuring of the credit union sector and operates independently of the Central Bank, ReBo submits proposals on

transfers to the Central Bank which the Central Bank may approve or reject. Section 40 of the 2012 Act prescribes that the independence of the Central Bank shall not be affected by anything relating to Part 3 of the 2012 Act. In this manner, the Central Bank maintains full discretion and independence over decision making process for transfer of engagements.

There is a high degree of accountability for the Central Bank. Section 6 and 6A of the Central Bank Act, 1942 set out the Central Bank functions, objectives and independence. A strategic plan must be prepared every three years and submitted to the Minister for Finance. The strategic plan is also laid before the Houses of the Oireachtas. The Central Bank is required to prepare a statement relating to the Central Bank's performance in regulating financial services. Similarly, the Registrar of Credit Unions is required to prepare an annual report of its activities for submission to the Central Bank. Section 32M of the Central Bank Act, 1942 sets out the requirement for an international peer review to be carried out every four years. Section 3(2) of the 1997 Act requires that every order or regulation made under the 1997 Act be laid before each House of the Oireachtas. The Central Bank Act, 1942 section 33X provides the process by which the Registrar of Credit Unions may be appointed and dismissed by the Central Bank. Section 6 of the Central Bank and Credit Institutions (Resolution) Act 2011 provides that nothing in that Act shall prevent the performance by the Governor or the Central Bank of their functions in relation to any credit institution (including credit unions). Sections 27A and 85 of the 1997 Act contain regulation making powers including powers to set requirements for regulatory ratios and systems and controls to be maintained. Sections 8, 10–13 and 30 of the 2012 Act (which amends the 1997 Act) include regulation making powers of the Central Bank in relation to prudential requirements, covering savings, borrowings, lending, investments, reserves and liquidity. These regulation making powers are yet to be commenced. While Part 3 of the 2012 Act deals with restructuring and the establishment of ReBo, section 40 of Part 3 covers the independence of the Central Bank and states that nothing in Part 3 shall prevent or restrict the performance by Central Bank or its Governor of functions in relation to any credit union including functions under financial services legislation.

Section 18E of the Central Bank Act, 1942 contains provisions in relation to advisory groups that the Central Bank may and shall establish. This section was inserted into the Central Bank Act, 1942 on 1 October 2010. Section 18E(1)(b) provides that the Central Bank shall establish an advisory group to advise the Bank, where the Bank so requests, on the performance of its functions and the exercise of its powers in relation to credit unions. Given the establishment of the Commission on Credit Unions (May 2011 – March 2012) and the Commission on Credit Unions Implementation Group (May 2012 – May 2014), an advisory group for credit unions has not been established to date.

GUIDING PRINCIPLE 1.5. The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives.

Description and Findings – GUIDING PRINCIPLE 1.5: The Central Bank's regulatory strategy for the credit union sector is set out in the 2013-2015 Strategic Plan. Three key objectives underpin the Central Bank's credit union sector work: 1) resolve weak and non-viable credit unions to protect members' savings and maintain financial stability within the credit union sector; 2) develop an appropriate legislative and regulatory framework to protect the stability of individual credit unions and to allow the sector to develop; and 3) bring about longer term restructuring of the sector to ensure its long-term sustainability. The Central Bank annually publishes its objectives, as set out in the Strategic Plan, along with the extent of their achievement.

GUIDING PRINCIPLE 1.6. The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.

Description and Findings – GUIDING PRINCIPLE 1.6: Central Bank governance is structured to ensure that decisions are taken at the appropriate level and in a timely manner. This is reflected in a number of ways - the supervisor, delegation of powers and the establishment of three significant committees, the Policy Committee, the Supervisory Committee and the Financial Stability Committee, as well as RGPs.

The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at the appropriate level depending on the significance of the issue. Decisions are escalated from the supervisor to his/her line manager and, if necessary, to senior management in RCU and certain committees/panels of the Central Bank depending on the seriousness of the supervisory decision to be taken. Advice is also sought, as required, regarding supervisory decisions from the Legal and/or Enforcement divisions of the Central Bank.

With regard to the delegation of powers, the performance and exercise of the Central Bank functions and powers have been delegated to the Registrar of Credit Unions under section 33AA of the Central Bank Act, 1942. These powers include the power to register a society under the 1997 Act as a credit union, petition the High Court to appoint an examiner and wind up a credit union, give regulatory directions to credit unions, and to make regulations.

The Central Bank Commission has approved a "delegation of powers" framework together with an extensive assignment of responsibilities pursuant to section 32A of the Central Bank Act, 1942. This framework is clear and sets out the decisions that are permitted to be taken by specified staff, thus ensuring that decisions are taken at the appropriate level and in a more timely manner. The Committees and RGPs established by the Central Bank have specific mandates in terms of their decision-making process.

GUIDING PRINCIPLE 1.7. The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes: (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the credit union; (b) salary scales that allow it to attract and retain qualified staff; (c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks; (d) a budget and programme for the regular training of staff; (e) a technology budget sufficient to equip its staff with the tools needed to supervise the credit union industry and assess individual credit unions; and (f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g. supervisory colleges).

Description and Findings – GUIDING PRINCIPLE 1.7: The Central Bank is an autonomous entity that is self-funding. Regulated entities currently fund 50% of the costs incurred by the Central Bank for financial regulation with certain exceptions. The Central Bank applies levies on credit unions which go toward funding its regulatory duties and activities, as set out in the Central Bank Act, 1942, section 32D. Regulations made under this section do not take effect until approved by the Minister for Finance. Section 32I of the Central Bank Act, 1942 states that if at any time it appears to the Commission that the funds raised from levies and fees prescribed by regulations in force under sections 32D and 32E are, or are likely to be, insufficient to enable the Bank to properly perform its regulatory functions, the Bank may apply to the performance of these functions such amount as the Commission deems necessary, subject to approval by the Minister for Finance. The costs of supervisory activities include both supervisory staff costs and non-staff costs such as external experts, training and other overheads.

Since 2010 there has been an increase in the number of staff in RCU with numbers increasing from approximately 28 in 2010 to approximately 58 in March 2015. The staff increase has been used by RCU to seek to respond to 1) the challenges being experienced by the credit union sector, particularly financial and business model challenges and the need for sector restructuring and 2) the new strengthened regulatory framework being introduced for credit

unions. There is ongoing manpower planning within the Central Bank to seek to ensure that an adequate level of resources is allocated 1) that is appropriate for the activities to be undertaken by RCU and 2) that takes account of the challenging circumstances of the credit union sector. There is also constant evaluation of both the level of staff and their skill sets to ensure that the requisite level of expertise is available to carry out its duties.

In addition to ongoing supervision, RCU has allocated resources to the areas of restructuring (dedicated I&R team of 12 staff as of 31 March 2015) and policy development. This number included 2 individuals who are on contract from professional services firms and do not form part of RCU's staff complement. This allocation reflects the particular stage of maturity of the credit union sector including the significant level of regulatory change, the credit union sector restructuring, and the challenging operating environment for credit unions.

Table 1.7 Staff complement of numbers in RCU (broken down by internal teams)

	Dec. 2010	Dec. 2011	Dec. 2012	Dec. 2013	Dec. 2014
Management	2	3	3	3	3
Supervision (including I&R from 2012)	19.8	23.8	38.8	38.8	38.8
Off-site financial analysis ¹⁴	4	6	6	6	6
Policy	2	6	7	7	7
Departmental Operations		1	3	3	3
Total	27.8	39.8	57.8	57.8	57.8¹⁵

These figures reflect the approved complement of permanent staff in RCU. Occasionally, some seconded staff are used to supplement full time resources given the significant workload associated with sector restructuring and compliance. Staff employed in RCU have a range of backgrounds and are suitably qualified for their role. As a Public Sector entity the Central Bank cannot offer the same level of remuneration and benefits as are available in the private sector. The Central Bank has flexibility to decide the appropriate the entry point of new staff taking account of skills and experience. Further, greater certainty of tenure, a significant training budget for training and development, and a defined benefit pension scheme are tools that are used to attract and retain staff. The Central Bank's review of its internal organization currently underway includes a review of measures to attract and retain suitably qualified and experienced staff.

¹⁴ Information provided by Central Bank: The work of the off-site financial analysis team also included work in relation to internal IT projects and credit union IT surveys.

¹⁵ Information provided by Central Bank: Staff complement at 31 March 2015 remained at 57.8.

Many Central Bank staff members were subject to pay cuts and reduced pension levels under the Financial Emergency Measures in the Public Interest Acts 2009 and 2013 (FEMPI Acts). While the FEMPI Acts are temporary and expected to end in 2015, there is no assurance that the FEMPI Acts will not be extended. At the time of the ICURN Credit Union Peer Review there were vacancies in Supervision (including in I&R) and Policy for a total of 6.

The Central Bank as an organization has a significant training budget. Staff can participate in the Academic and Professional Training Scheme (APTS) which provides support to staff to pursue relevant third level, post graduate and approved professional qualifications. In addition, RCU has its own training budget which is utilized for specific supervisory training identified as part of its Training Needs Analysis, used to identify any gaps/weaknesses in the current complement of staff and identify future gaps based on the supervisory strategy/plan. A greater focus on leadership development and empowerment is being developed under the Registrar of Credit Unions and an RCU specific program is being put in place with support and involvement from the Learning and Development team in the Central Bank's Human Resource Division. In terms of career paths, the Central Bank operates a hierarchical grade structure which facilitates staff promotion as and when vacancies or new roles arise. The Central Bank is currently engaged in an extensive review of its internal organization as referred to above to ensure the conditions for steady improvements in the effectiveness of its work. The Central Bank operates a centralized technology budget. RCU has a travel budget which facilitates staff undertaking relevant business travel to carry out their supervisory work.

In 2014 RCU turnover, based on staff leaving the Central Bank and staff transferring to other divisions in the Central Bank, was 20%. For January-April 2015, the turnover percentage on this basis is 17%. When internal transfers are excluded RCU turnover was 7% in 2014 and 9% for the period January-April 2015.

The Central Bank can, where required, commission external experts to conduct supervisory tasks under the 1997 Act. RCU may request a credit union to appoint a consultant to undertake an asset review and/or a review of their governance and operational structure. This may be paid for by the credit union. In addition, RCU has a Consultancy Budget whereby external consultants can be engaged to undertake asset reviews of certain credit unions with underlying financial concerns. The Central Bank (Supervision and Enforcement) Act 2013 also provides new powers in relation to third-party skilled persons reports (Part 2) and enables the Central Bank to appoint non-employees as authorized officers who will be able to use the new authorized officer powers under this Act (Part 3).

GUIDING PRINCIPLE 1.8. Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.

Description and Findings – GUIDING PRINCIPLE 1.8: The Central Bank and its employees have statutory protection from being liable in damages for actions carried out while performing the functions of the Central Bank provided they have not acted in bad faith. Section 84(3) of the 1997 Act provides that the Central Bank and its employees in the RCU are not liable in respect of any losses incurred through the insolvency or default of a credit union. The Central Bank has not paid any compensation arising from litigation in the past five years.

GUIDING PRINCIPLE 1.9. Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of credit unions, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.

Description and Findings – GUIDING PRINCIPLE 1.9: Collaboration with other authorities in relation to safety and soundness of credit unions does not arise inasmuch as the Central Bank is solely responsible for the supervision of financial service providers, including credit unions, and coordinates all supervisory activity and therefore, the Central Bank undertakes the relevant functions. Governance arrangements within the Central Bank, however, ensure that there is cooperation and sharing of information between the respective areas of the Central Bank as evidenced by various Central Bank committee structures such as the Governor's Committee, Senior Leadership Committee, Financial Stability Committee, Supervisory Committee and Policy Committee.

The Central Bank does collaborate and share information, though, with other domestic authorities which have an interest in the overall stability of the financial system (e.g. Department of Finance) and responsibility for monitoring compliance with other relevant legislation (e.g. financial crime and fraud). Liaison is required from time to time with the Department of Finance and/or Minister for Finance, with the Garda Síochána (the Irish Police Force), the Revenue Commissioners and with IAASA. This sharing of information with other domestic authorities is subject to the confidentiality requirements set out in section 33AK of the Central Bank Act, 1942.

In 2007, an MOU was agreed on financial stability between the Department of Finance, the Central Bank and Financial Services Authority of Ireland and the Irish Financial Services Regulatory Authority. In 2008, an MOU was agreed between the Central Bank and IAASA which allows the exchange of relevant information and cooperation in respect of investigation work of either party. In 2013, an MOU was agreed between the Central Bank and ReBo concerning the request and provision of financial and other information in relation to individual credit unions and the credit union sector.

GUIDING PRINCIPLE 1.10. Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.

Description and Findings – GUIDING PRINCIPLE 1.10: The resolution powers under the Central Bank and Credit Institutions (Resolution) Act 2011 are granted to the Central Bank and must be exercised by the Governor, or an individual to whom he has delegated the relevant authority. The Central Bank has created the SRU to assist the Governor's decision-making authority. Operationally separate, the supervisory function and the SRU sit within different directorates of the Central Bank. The Resolution and Corporate Affairs directorate includes SRU and credit union resolution in its area of responsibility.

Responsibility for supervision and resolution both rest within the Central Bank, which allows for a high level of interaction and information sharing at an earlier stage than would be the case where the resolution authority was completely separate. Four credit union resolution cases have been completed by the SRU to date under the Central Bank and Credit Institutions (Resolution) Act 2011. The legislation prescribes the intervention conditions that must be met before certain resolution actions can be undertaken. A protocol has been put in place between the supervisory function and the SRU in order to formalize this cooperation, setting out the principles for exchange of information and cooperation at all stages of the resolution process. The protocol covers areas including: early notification of financial distress; financial position confirmation; the formal referral from the supervisory function in RCU to the SRU; and the assistance to be given by RCU to the SRU following referral during an active resolution case. The Central Bank "Resolution Committee" handles resolution cases operationally and is comprised of the Head of SRU, the Registrar of Credit Unions, the Deputy Registrar of Credit Unions and other RCU supervisory staff, the Legal Division, the Press Unit, the Payments and Securities Settlements Division, senior management of the Central Bank, and other relevant divisions where resolution action is contemplated. The resolution process involves collaboration between the SRU and the Department of Finance.

Assessment of GUIDING PRINCIPLE 1: Compliant

Comment: There is a single competent authority responsible for credit union supervision, namely the Central Bank. Supervisory authority is clearly defined in legislation. The main pieces of legislation relating to credit unions are as follows: Central Bank Act, 1942; 1997 Act; Central Bank Reform Act 2010; Central Bank and Credit Institutions (Resolution) Act 2011; 2012 Act; and Central Bank (Supervision and Enforcement) Act 2013. In addition, the CJA 2010 applies to credit unions. Section 33AA of the Central Bank Act, 1942 delegates responsibility for managing the performance and exercise of functions of the Central Bank under the 1997 Act to the Registrar of Credit Unions.

When a credit union is not complying with laws and regulations, there is competent authority for RCU to give regulatory directions requiring a credit union to take corrective actions to address the situation, which can include: complying with any requirement breached; raising and maintaining reserves or other financial resources; applying a specified policy for making provisions; taking steps to strengthen internal systems and controls; and restricting the credit union's business, including restrictions on investments, lending, savings, making payments, and disposing of assets. RCU may also require a credit union to provide a written statement outlining the steps it will take to comply with any direction imposed. Further, appropriate authority exists for the credit union's registration to be revoked.

The operational independence, accountability and governance of the supervisor is prescribed in legislation and publicly disclosed. In addition, the Central Bank's objectives and extent of their achievement are annually disclosed as set out in the *2013-2015 Strategic Plan*. The Central Bank is currently engaged in an extensive review of its internal organization to ensure the conditions for steady improvements in the effectiveness of its work. The review is examining such issues as internal structure, career paths and internal processes.

Recommendation: Having undertaken the demanding task of introducing a comprehensive regulatory structure for credit unions, of gaining a sound understanding of the true health of the sector, and bringing about essential restructuring, the Central Bank should consider refocusing its attention, and scarce resources, on key risks, particularly Credit Risk, that have real potential to cause challenges to its objectives and impact longer term viability. Poor-quality underwriting and a failure to understand and apply the principles of sound lending have been, and remain, significant problems for many Irish credit unions. Achieving a permanent improvement in those areas will take considerable time and will not be achieved without continued focus and attention across the sector by the Central Bank.

RCU needs to ensure that it has the adequate level of resources necessary to deliver on all aspects of its regulatory strategy. The required level of resources will also need to take into account any additional resourcing requirements arising from the recommendations contained above in relation to "Supervisory Approach" and "Communications and Guidance." (See sections 2 and 6 of this report.)

Given the establishment of the Commission on Credit Unions (May 2011 – March 2012) and the Commission on Credit Unions Implementation Group (May 2012 – May 2014), an advisory group for credit unions has not been established to date. It may be appropriate at this time to consider the timeframe and arrangements for the establishment a Credit Union Advisory Group as provided for in the Central Bank Act, 1942.

We also suggest that consideration be given by the relevant authority to directing a closely-defined, limited, review to evaluate the implementation of the original recommendations of the CCU and to propose any revisions or measures thought necessary in light of that experience. Such a review could possibly be undertaken by the CUAC, if permissible under its Terms of Reference, with whom we met, as part of its important work in maintaining the impetus stemming from the CCU's Report. We accept that this is not itself a matter for the Central Bank, but simply note that we think such an exercise might prove valuable for both the Central Bank and for Irish credit unions in general.

GUIDING PRINCIPLE 2: PERMISSIBLE ACTIVITIES

The permissible activities of institutions that are licensed and subject to supervision must be clearly defined, and terminology used to describe the institutions undertaking these activities, such as credit unions, *caisses populaires* and SACCOs, must be restricted and controlled by the supervisory authority. The supervisory authority must have the power to enforce against the use of the restricted terminology by unlicensed entities. Business powers and permissible activities may be proportional to the institution's size and ability to manage the risks inherent in such services and compatible with its business objectives.

GUIDING PRINCIPLE 2.1. The permissible activities of institutions that are licensed and subject to supervision as credit unions are clearly defined either by supervisors, or in laws or regulations.

Description and Findings – GUIDING PRINCIPLE 2.1: The permissible activities of credit unions registered under the 1997 Act are clearly defined in laws and regulations. As provided for under the 1997 Act, credit unions are permitted to carry out the following activities: making loans, making investments, accepting savings, and borrowing. Regulations also provide that

credit unions can provide certain services to members including: account access by phone, account access by internet, third party payments (including Electronic Funds Transfer [EFT]), ATM services, bureau de change, certain insurance services on an agency basis, bill payment, money transfers, standing orders, direct debits, financial counseling, and PRSAs on an introduction basis. The Central Bank is currently consulting on draft regulations contained in the Consultation on Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act CP88. On commencement of the remaining sections of the 2012 Act, the following regulation making powers will be provided to the Central Bank: reserves, liquidity, lending, investments, savings and borrowings.

At present, if a credit union wishes to provide services to its members, in addition to those listed above, that are of mutual benefit to its members and do not impose undue risk to members' savings, they can apply to the Central Bank. Credit unions may also apply to the Central Bank for the approval of longer-term lending limits than those currently provided for under section 35 of the 1997 Act. A small number of credit unions have been approved for the provision of additional services to their members. Such approvals include approvals in relation to the provision of mortgages on a tied-agency basis and certain insurance services on an agency basis. For example, a Medium High Impact credit union applied for approval to provide mortgages to its members on an agency basis. The Central Bank approved the application subject to conditions to ensure appropriate systems and controls were in place and transparency was provided in relation to the parties involved in the provision of the service.

GUIDING PRINCIPLE 2.2. The use of the word “credit unions” and any derivations in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.

Description and Findings – GUIDING PRINCIPLE 2.2: Under section 12 of the 1997 Act, it is unlawful for a person, other than a credit union, who uses in reference to himself, a name, title or descriptive expressing containing the words "credit union" and "comhar creidmheasa¹⁶." The Central Bank publishes a register of credit unions registered under the 1997 Act on its website, allowing members of the public to see if a firm is a registered credit union. The Central Bank has a dedicated Unauthorized Providers Unit (UPU), which identifies and investigates alleged instances of unauthorized activity carried out by individuals or entities that are not otherwise authorized or regulated by the Central Bank. The Central Bank investigates instances of suspected use of prohibited terms, analyzes the facts in each instance on a case-by-case basis to assess whether summary prosecution is appropriate.

¹⁶ Comhar creidmheasa is the Irish for credit union.

To date, no instances on the use of restricted terminology by unlicensed entities have emerged which would merit the Central Bank invoking its powers.

GUIDING PRINCIPLE 2.3. The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks or credit unions.

Description and Findings – GUIDING PRINCIPLE 2.3: Section 7 of the Central Bank Act of 1971 provides that only banks holding a banking license may accept deposits or other repayable funds from the public. The following exceptions, which include credit unions, are provided for: a building society, an industrial and provident society, a friendly society or a credit union. As such, credit unions can accept deposits and are regulated by the Central Bank under the 1997 Act.

GUIDING PRINCIPLE 2.4. The supervisory authority must have the power to enforce against the use of the restricted terminology by unlicensed entities.

Description and Findings – GUIDING PRINCIPLE 2.4: Any person, other than a credit union that uses the terms "credit union" or "comhar creidmheasa," or a cognate or derivate of these terms is guilty of an offence. In addition any person, other than a credit union, that represents themselves as a credit union is guilty of an offence. The Central Bank can take an enforcement action against the use of restricted terminology or misrepresentation by unlicensed entities.

GUIDING PRINCIPLE 2.5. Business powers and permissible activities may be proportional to the credit union's size and ability to manage the risks inherent in such services and compatible with its business objectives.

Description and Findings – GUIDING PRINCIPLE 2.5: All credit unions are permitted to undertake the same type of business activities; however, the scale of activities that credit unions may undertake takes account of the scale of the credit union. For example, the size of loan a credit union can make is related to the scale of the credit union. Credit unions are required to ensure that they have adequate resources taking account of the nature, scale, complexity, and risk profile of the activities being undertaken and the governance arrangements to ensure they have effective oversight of the business being conducted by the credit union. In considering applications from credit unions for approval of additional services, RCU takes account of the credit union's size and ability to manage the risks inherent in such services and ensures they are supported by a robust business case and that systems and controls are in place to manage and mitigate any risk involved.

Assessment of GUIDING PRINCIPLE 2: Compliant

GUIDING PRINCIPLE 3: LICENSING

The supervisory authority must have the power to establish and enforce the necessary criteria for licensing entrants. At a minimum, the licensing process should consider ownership (must be a cooperative structure), governance, fitness and propriety of board members and management, strategy, risk management and capital. This is not intended to be an exhaustive list, and supervisory authorities should consider additional criteria needed to facilitate effective supervision in their regimes.

***GUIDING PRINCIPLE 3.1.** The law identifies the authority responsible for granting and withdrawing credit union registration. The licensing authority could be the credit union supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed credit union. The supervisor imposes prudential conditions or limitations on the newly licensed credit union, where appropriate.*

Description and Findings – GUIDING PRINCIPLE 3.1: The Central Bank is the sole authority with the power and responsibility for registering¹⁷ credit unions in Ireland in accordance with provisions of the 1997 Act. The Central Bank is also the supervisory authority of credit unions. On registration, a new credit union would be subject to the prudential and governance requirements that apply to all credit unions. The Central Bank can also impose additional requirements on a new credit union. When section 13 of the 2012 Act is commenced, the Central Bank will also be able to impose an initial reserve requirement for newly registered credit unions. The draft regulations on Reserves in CP88 propose that newly registered credit unions will be required to maintain initial reserves.

***GUIDING PRINCIPLE 3.2.** Laws or regulations give the licensing authority the power to set criteria for licensing credit unions. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or supervisor determines that the license was based on false information, the license can be revoked.*

¹⁷ Under the 1997 Act, credit unions are registered rather than licensed.

Description and Findings – GUIDING PRINCIPLE 3.2: The Central Bank has the power to refuse an application for registration as a credit union and the Central Bank must inform the applicant of the reasons for the refusal. A "Checklist for completing and submitting Credit Union Registration Applications" sets out the criteria needed. The Central Bank's regulatory document, "Credit Union Registration Applications - Guidelines on completing and submitting Credit Union Registration Applications," and the above-mentioned Checklist, which are available to inquiring parties, provide guidance on the criteria to be fulfilled and information required when applying for credit union registration. Section 97(1)(a)(ii) of the 1997 Act provides the Central Bank with the power to cancel the credit union registration if the registration was obtained by fraud.

GUIDING PRINCIPLE 3.3. *The licensing authority determines that the proposed legal, managerial and operational structures of the credit union will not hinder effective supervision. The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.*

Description and Findings – GUIDING PRINCIPLE 3.3: Although the Central Bank has not yet received a formal application for registration as a credit union since becoming the regulator of credit unions, the application process and supporting documentation, developed by the Central Bank, require the review of the proposed legal, managerial and operational structure of the applicant to ensure the application meets all legal and regulatory requirements and would not hinder effective supervision or implementation of corrective measures in the future. The "Checklist for completing and submitting Credit Union Registration Applications" is comprehensive and contains detailed information on such matters as the location of the registered office, details on information systems, and details on credit union oversight, among others.

GUIDING PRINCIPLE 3.4. *The licensing authority, at authorization, evaluates the credit union's proposed Board members and management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the credit union; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a credit union. The licensing authority determines whether the credit union's Board has collective sound knowledge of the material activities the credit union intends to pursue, and the associated risks.*

Description and Findings – GUIDING PRINCIPLE 3.4: There is legislation in place and standards governing the fitness and probity that the board of directors, management and individuals carrying out certain other positions in a credit union must meet both before and once they undertake their position in a registered credit union. These standards include requirements in relation to competence, conflicts of interest, financial soundness, and acting honestly, ethically, and with integrity. A person is also prohibited from being an officer (which includes management) in a credit union if they are bankrupt or have been convicted of an offence of fraud or dishonesty in relation to a credit union. The Central Bank must approve the proposed chair of the board of directors and the proposed manager of the credit union prior to registering the credit union.

On 24 September 2012, Part 3 of the Central Bank Reform Act 2010 commenced for credit unions, providing a statutory system for the regulation by the Central Bank of individuals performing Controlled Functions (CFs) or Pre-approval Controlled Functions (PCFs). A new Fitness and Probity regime for credit unions came into effect of 1 August 2013 and will be fully implemented by 1 August 2016. A credit union is not permitted to appoint a person to perform a CF unless it is satisfied on reasonable grounds that the person complies with the Standards and that the person has agreed to abide by them. The Standards require the person applying for a PCF role to have the qualifications, experience, competence, and capacity appropriate to the relevant function. With regard to competence of members of the board of directors, the Central Bank has provided guidance, Guidance on Fitness and Probity for Credit Unions, on the minimum competencies required for members of the board of directors and the chair of the credit union.

GUIDING PRINCIPLE 3.5. The licensing authority reviews the proposed strategic and operating plans of the credit union. This includes determining that an appropriate system of governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the credit union.

Description and Findings – GUIDING PRINCIPLE 3.5: While RCU has not received any formal application to register a credit union since the Central Bank assumed responsibilities for credit unions in 2003, RCU will review all credit union registration applications. As part of this review, an assessment will be made as to whether the applicant's proposed strategic and operating plans are feasible. Follow up will be carried out on any matters that arise from the assessment. Following the review, a recommendation on the application will be forwarded to the RCU's management for approval. Using the Central Bank's Internal Procedures document,

governance, risk management and internal controls including those related to the detection and prevention of criminal activities, and oversight of the proposed outsourcing functions will be assessed in detail. Although the scope and degree of sophistication of proposed activities of a credit union are limited by the activities permitted for credit unions under the 1997 Act, RCU's assessment is required to ensure that the proposed operational structure and resources are sufficient to support any proposed business areas involving complexity, such as business lending, EFT and debit cards.

Assessment of GUIDING PRINCIPLE 3: Compliant

Comment: The Central Bank has not received any formal application to register a credit union since the Central Bank assumed responsibility for registering, regulating, and supervising credit unions in 2003. The most recent credit union registration took place in 1999. However, the Central Bank has developed guidance, which is available to inquiring parties, on the criteria and information required to support an application to register a credit union.

GUIDING PRINCIPLE 4: OWNERSHIP

The supervisory authority should ensure the structure of any proposed institution complies with cooperative principles, recognizing that some second-tier organizations have proportional voting for members. It is not appropriate for any individual or group of individuals to be in a position to exercise control from a minority position. Voting in credit union support organizations or associations may be proportional or representational.

GUIDING PRINCIPLE 4.1. The supervisory authority should ensure the structure of any proposed credit union complies with cooperative principles, recognizing that some second-tier organizations have proportional voting for members.

Description and Findings – GUIDING PRINCIPLE 4.1: Section 6 of the 1997 Act sets out conditions for registration as a credit union, which include the condition that membership must be restricted to those who have a common bond and that the credit union is being formed for specified objects set out in the legislation. A common bond is a grouping based on a pre-existing connection such as belonging to a particular community, industrial or geographic group. These objects reflect cooperative principles such as the social goals of education and the promotion of thrift.

Section 17 of the 1997 Act sets out provisions in relation to the requirements of and qualification for membership. Section 82(2) of the 1997 Act sets out the voting rights of credit

union members - each member shall have only one vote at an AGM or SGM irrespective of his or her shareholding in the credit union, establishing the cooperative principle of equal voting rights or "one member, one vote" in legislation.

GUIDING PRINCIPLE 4.2. It is not appropriate for any individual or group of individuals to be in a position to exercise control from a minority position.

Description and Findings – GUIDING PRINCIPLE 4.2: Section 55(2) of the 1997 Act requires the board of directors to ensure that no single person (1) is responsible for making all of the material decisions of the credit union or (2) has effective control over the business of the credit union in deciding on the roles, responsibilities, and administrative structures and reporting relationships of all officers. All credit unions are required to have a set of registered rules. The 1997 Act additionally includes a savings limit which limits the savings an individual member may have in a credit union to the greater of €200,000 or 1% of total assets, which is another measure that can help ensure that no member may exercise control by reason of the extent of their savings and the potential impact on the credit union arising from the withdrawal of these savings. The draft savings regulations set out in CP88 would, on commencement of section 8 of the 2012 Act, change the savings limit an individual member may have in a credit union to €100,000.

Assessment of GUIDING PRINCIPLE 4: Compliant

GUIDING PRINCIPLE 5: CAPITAL ADEQUACY

The supervisory authority must establish and enforce the rules for an appropriate capital framework with which all regulated institutions must comply. The rules should balance cooperative principles and objectives with the need to protect depositors. Accordingly, supervisory authorities will need to carefully consider what meets the criteria for capital and to ensure that capital instruments are able to absorb losses in the event of failure. When supervisors choose to align the capital requirements of credit unions to Basel standards, a simplified approach may be adopted for small or simple credit unions that are not allowed to hold complex financial instruments. For such institutions, compliance with the most advanced risk measurement techniques may be beyond their resources. Therefore, the regulator may require additional capital to support the limited information that may be available for supervisory authorities.

GUIDING PRINCIPLE 5.1. Laws, regulations or the supervisor require credit unions to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a credit union might be subject to supervisory action. Laws, regulations or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.

Description and Findings - GUIDING PRINCIPLE 5.1: Capital (regulatory reserves) requirements are set out in the 1997 Act and in Statutory Instrument No. 344 of 2009 - Credit Union Act 1997 (Section 85) Rules 2009 (S.I. 344). In Ireland credit unions hold reserves, rather than capital, which consist of retained earnings from previous years.

Section 45 of the 1997 Act sets out the eligible components of regulatory reserves and the requirement for an annual 10% allocation to reserves from surpluses. S.I. 344 establishes the minimum Regulatory Reserve Ratio of 10% based on total assets. Of this, a minimum of 8% of total assets must be held in the Statutory Reserve. The remaining 2% of total assets required to meet the Regulatory Reserve Ratio may be held in either the Statutory Reserve or Additional Regulatory Reserve.

Section 55 of the 1997 Act also sets out the functions of the board of directors, which includes the requirement for establishing reserve management policies. The Central Bank has issued comprehensive guidance in the *Credit Union Handbook* which sets out minimum expectations surrounding reserve requirements and policy considerations. These include procedures for complying with minimum regulatory reserve requirements and guidance, contingency plans if reserve targets are not met, and notifying the Central Bank when reserves fall below minimum regulatory requirements. In these circumstances, the board of directors is required to take appropriate measures to restore reserves to the required level as soon as possible subject to timelines agreed by the Central Bank.

Credit unions are required to submit an annual compliance statement with Part IV of the 1997 Act which addresses responsibilities in a number of governance and risk management areas, including responsibilities under section 55 of the 1997 Act for the board of directors to approve, review and update reserve management policies. Where material non-compliance issues are identified, credit unions are required to submit a report to the Central Bank providing details of the material deviation and remedial action taken or proposed. Credit unions are also required to submit quarterly and year end Prudential Returns and annual audited accounts. The Central Bank conducts on-going assessments and monitoring of the reserve position of credit unions based on these reports and uses key risk indicators (KRI) to track any material changes and actual or potential shortfalls.

Under revisions to section 45 of the 1997 Act which are planned to come into effect at the end of 2015, where a credit union fails to meet any reserve requirement, credit unions will be required to obtain written approval from the Central Bank before paying a dividend or a loan interest rebate.

Thresholds for Supervisory Action

A credit union will be subject to supervisory action where it is unable to meet minimum regulatory reserve requirements within an agreed timeframe based on the circumstances and severity of the reserve shortfall involved. Where a reserve shortfall is likely to persist, the credit union will be issued with a formal notice setting out the Central Bank's concerns regarding the financial position of the credit union and requiring a detailed plan setting out specific actions and timelines for restoring their reserve position. Where necessary, the credit union may be formally directed to restore their reserve position within the timeline specified, failing which resolution strategies may be implemented. At the time of the ICURN Credit Union Peer Review there were 10 credit unions with regulatory reserves below the 10% minimum requirement. These credit unions were under the supervision of the I&R team, which is responsible for the on-going supervision of credit unions that have signs of significant financial distress and are subject to special supervisory engagement tailored to reflect the individual circumstances of these credit unions.

Qualifying Components of Capital

Qualifying components of regulatory reserves must be realized, unrestricted and non-distributable. Member shares are not included as they can be withdrawn by members on demand. Statutory reserves are limited to retained earnings which have been built up over time from allocations of annual surpluses, with a minimum allocation requirement of 10% in each financial year. (Under new rules, the 10% minimum allocation from surpluses is to be eliminated.) The Central Bank has provided guidance on the income recognition in the context of determining whether surpluses have been realized which indicates investment income should be excluded from surpluses, if it will not be received within 12 months of the balance sheet date.

Under the Regulatory Reserve Ratio requirement, a minimum of 8% of total assets must be held in the Statutory Reserve. The remaining 2% of total assets required to meet the Regulatory Reserve Ratio may be held either in the Statutory Reserve or as an "Additional Regulatory Reserve."

GUIDING PRINCIPLE 5.2. *The prescribed capital requirements reflect the risk profile and systemic importance of credit unions in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in credit unions and the credit union sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.*

Description and Findings - GUIDING PRINCIPLE 5.2: Under section 45 of the 1997 Act all credit unions are required to establish a statutory reserve and to allocate 10% of surplus funds of the credit union in each financial year to it. Section 45 of the 1997 Act also provides that credit unions with statutory reserves equal to or above 15% can decrease this allocation subject to recommendations by the board of directors and approval by the membership at a general meeting. Further reserve requirements were introduced in 2009 by way of S.I. 344. This was largely driven in response to the financial crisis and macroeconomic conditions prevailing in Ireland at that time and the need to ensure the future long term viability of the credit union sector. Credit unions have a very high community profile and membership penetration and have an important and necessary role in the financial services sector in Ireland. Under these revised reserve rules, credit unions were required to maintain minimum regulatory reserves of 10% by September 30, 2009. While feedback on the consultation of these proposals indicated unanimous support for the concept of maintaining strong reserves in credit unions and the sector overall, it was recommended that implementation timeframes should be extended. As a result, the timeframes to achieve full compliance were modified by the Central Bank to allow for a longer, phase-in period where required (subject to certain restrictions) with a minimum of 7.5% by September, 2009 increasing to 10% by September 30, 2013. At the time these changes were introduced, aggregate reserves were in excess of 10% and have been increasing since then.

Table 5.2. Selected Credit Union Financial Indicators: 2008-2014

	Dec. 2008	Dec. 2009	Dec. 2010	Dec. 2011	Dec. 2012	Dec. 2013	Dec. 2014
Assets (billions)	14.2	14.5	14.3	13.8	13.7	13.9	14.3
Minimum Regulatory Reserve Ratio (in line with Central Bank requirements)	N/A	7.5%	8.0%	8.5%	9.0%	10.0%	10.0%
Average Realized Reserve Ratio	12.4%	12.8%	12.4%	13.0%	14.3%	14.9%	15.8%
Loans to Assets	52%	48%	44%	41%	36%	32%	29%
Loan Arrears >9 weeks	8%	12%	17%	19%	20%	19%	17%
Loan Loss Provisions	4%	7%	12%	15%	18%	20%	20%

The new minimum regulatory reserve requirement of 10% is in line with the recommendation of WOCCU from the *WOCCU Technical Guide: Credit Union Regulation and Supervision*, and takes account of the limitations on the ability of credit unions to generate reserves other than by way of retained earnings. WOCCU also recommends that loan arrears >30 days as a percentage of total loans should not exceed 5%. Aggregate loan arrears in the Irish credit union sector >9 weeks (63 days) as a percentage of total loans have been well above these thresholds over a number of years. The Central Bank has proposed the development of a new provisioning framework to ensure consistency and clarity in the manner in which credit unions calculate their provisioning given that lending is primarily unsecured. This will include the recognition of loan losses as early as possible and the adoption of a sufficiently conservative and comparable approach. In the event that credit unions identify the need for additional provisions in the future, including arising from the planned new provisioning framework, this could impact the level of reserves in some individual credit unions over time.

GUIDING PRINCIPLE 5.3. When supervisors choose to align the capital requirements of credit unions to Basel standards, a simplified approach may be adopted for small or simple credit unions that are not allowed to hold complex financial instruments. For such credit unions, compliance with the most advanced risk measurement techniques may be beyond their resources. Therefore, the regulator may require additional capital to support the limited information that may be available for supervisory authorities.

Description and Findings - GUIDING PRINCIPLE 5-3: The current reserve requirement based on total assets is considered appropriate for the current business model and reflects the level of maturity of the credit union sector in Ireland at this time. The business undertaken by Irish credit unions currently does not involve complex lending, investments or savings products. For example, lending is highly concentrated (over 90%) in unsecured personal loans, with the balance of other lending distributed between secured mortgage loans, business loans and development loans. Paragraph 6 of S.I. 344 indicates certain circumstances where the Central Bank may consider a weighted approach to regulatory reserves.

In 2013, CP76 was issued seeking views on a number of issues and made reference to the possibility of a risk weighted approach for larger more complex credit unions following the restructuring of the credit union sector. The Central Bank has indicated that consideration will be given to a risk weighted asset approach following restructuring of the credit union sector. The complexities for credit unions in implementing a risk weighted approach, including the systems, controls and reporting arrangements required, would need to be considered prior to adopting such an approach.

Assessment of GUIDING PRINCIPLE 5: Compliant

Comment: The Central Bank has prescribed minimum regulatory reserve levels that are in line with international recommendations supported by WOCCU and appropriate for the transitional state of the Irish credit Union sector at this time. The sector supports the maintenance of strong reserves to ensure its long term viability and stakeholders have indicated the need to address individual credit union circumstances of non-compliance with the minimum regulatory reserve requirement on a timely basis. Current on-site and off-site supervisory assessment and monitoring activities provide assurance that reserve requirements are met and that non-compliance issues are effectively resolved. While the current aggregate level of reserves for the sector appears high, there are some individual credit unions that are reporting that they are not meeting the minimum regulatory reserve requirement, and in some other credit unions the level of reported reserves may not fully reflect potential loan loss experience.

Prescribed reserve components and criteria help ensure that reserves are able to absorb losses in the event of failure. Member shares are not included and only realised, unrestricted and non-distributable reserves may be included. Comprehensive guidance has been provided by the Central Bank on policy and reserve management practices including the need to maintain appropriate levels of reserves above the minimum regulatory requirements based on the nature, scale, complexity and risk profile of a credit union and to support current and planned operations. The Central Bank intends to further explore the possibility of implementing a risk weighted approach for certain credit unions following the restructuring of the credit union sector. Initially, this may involve a modified approach to appropriately reflect the limited scale and complexity of the sector.

GUIDING PRINCIPLE 6: RISK MANAGEMENT

Regulated institutions must have appropriate and adequate risk management processes and systems in place. The risk management system must be able to identify, evaluate, monitor, manage and control the risks to which the regulated institution may be exposed. Policies and limits for risk undertakings must be clearly established and periodically reviewed. The risk management system should be commensurate with the size and complexity of the institution and its activities.

GUIDING PRINCIPLE 6.1. The supervisor determines that credit unions have appropriate risk management strategies that have been approved by the credit unions' Boards and that the Boards set a suitable risk appetite to define the level of risk the credit unions are willing to assume or tolerate. The supervisor also determines that the Board ensures that: (a) a sound risk management culture is established throughout the credit union; (b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite; (c) uncertainties attached to risk measurement are recognised; (d) appropriate limits are established that are consistent with the credit union's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and (e) management take the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.

Description and Findings - GUIDING PRINCIPLE 6.1: Under the regulatory framework credit unions are required to have a risk management system, including a risk management policy and process, to identify, evaluate, monitor, manage and control the risks to which the credit union may be exposed. The risk management policy must be reviewed and updated regularly (at least annually) by the board of directors. The board of directors is also required to implement a risk management process that ensures that all risks are identified and mitigated to a level consistent with the risk tolerance of the credit union.

The risk management system must be clearly documented and set out the related tasks and responsibilities within the credit union.

The Central Bank has provided guidance on risk management requirements which includes the role of the board of directors in promoting a strong risk management culture within the credit union, including communicating policies, roles and responsibilities relating to risk management to all officers of the credit union.

The Central Bank has indicated in guidance that risks identified by the risk management system should be documented in a register including a risk description; risk area; risk mitigating systems and controls; effectiveness of systems and controls; and residual risk ratings. Central Bank guidance also requires the board of directors to consider risk events, changes in the financial position, external environment and strategic plan of the credit union to address any deficiencies which help ensure that uncertainties to risk measurement are recognised.

As set out in Central Bank guidance, credit unions should document their risk tolerance statement, setting out the quantified level of risk that the credit union is willing to accept in various risk areas in pursuit of its strategic objectives. This is also reflected in a number of credit union policies. For example under the 1997 Act, all credit unions are required to have lending policies, including lending limits, which will reflect the credit union's risk appetite. Credit unions should also establish effective channels of communication and review compliance with limits.

Under section 76C of the 1997 Act all credit unions are required to appoint a risk management officer with the necessary authority and resources to manage the risk management function within the credit union. The board of directors must ensure that the risk management officer has clearly documented reporting lines and access to the board of directors and is independent in the exercise of its functions. Central Bank guidance sets out the minimum responsibilities of the risk officer which includes ensuring each internal/external risk of the credit union is identified, assessed, reported and monitored, and assisting with managing and mitigating those risks.

Supervision

On-going supervision of risk management is assessed through issues raised in auditors' management letters and internal/external reports. In addition, all credit union are required to submit an annual compliance statement with Part IV of the 1997 Act to the Central Bank which includes provisions relating to risk management. Where a credit union identifies material non-compliance with the requirements of Part IV of the 1997 Act, it must submit a Report of Material Non-Compliance to the Central Bank, including details of how and when the non-compliance will be rectified. In the event of any risk management issues being identified, follow-up action is undertaken as appropriate by the supervisor.

In addition to on-going supervision, risk management practices are also assessed as part of on-going PRISM on-site engagements. These can include meetings with key credit union management personnel, board of directors and the risk management officer as specified in the PRISM engagement model and on-site testing as appropriate (see Guiding Principle 18 for details of the PRISM engagement model). Risk guidance materials have been developed which set out a number of considerations that supervisors may use when assessing the quality of risk management practices and compliance to regulatory requirements.

These considerations are closely aligned with the requirements set out in Guiding Principle 6.1 above and include:

- verifying that there is a risk management system in place;
- reviewing the risk management policy and the risk tolerance statement;

- reviewing the risk register;
- reviewing how management information is provided to the board of directors; and
- reviewing minutes of meetings of the board of directors.

In determining the appropriateness of risk management strategies, supervisors expect to see risk profile considerations including thresholds and limits, reflected in board-agreed policies, demonstrated through functional operational processes, and subject to independent assessment by internal audit.

Findings in relation to risk management are communicated to the credit union's board of directors through the issues of an RMP setting out any deficiencies found, the mitigating action to be taken and the timeframe for implementation of the mitigation action.

During 2015 risk management processes will be assessed, as appropriate, during credit union engagements that are carried out in line with the Temporary Engagement Model for 2015. This will include engagement with Low Impact credit unions. A separate engagement model has been established for credit unions that are supervised by the I&R team.

GUIDING PRINCIPLE 6.2. The supervisor requires credit unions to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate: (a) to provide a comprehensive “credit union-wide” view of risk across all material risk types; (b) for the risk profile and systemic importance of the credit union; and (c) to assess risks arising from the macroeconomic environment affecting the markets in which the credit union operates and to incorporate such assessments into the credit union’s risk management process.

Description and Findings - GUIDING PRINCIPLE 6.2: The Central Bank has provided guidance on the risk management process. This includes risk identification which should provide a comprehensive "credit union-wide" view of risk across all material risk types relevant to a credit union. These include capital risk, credit risk, environmental risk, governance risk, liquidity risk, market risk, operational risk and strategy/business model risk.

The Central Bank has also indicated in guidance that credit unions should take the nature, scale and complexity of the business being conducted by the credit union into consideration when establishing governance arrangements, including arrangements in relation to risk management systems, systems and control, the risk management officer, the compliance officer and the internal audit function.

Guidance indicates that a credit union's risk management system should include an assessment of risks that the credit union is, or might reasonably be exposed to, through its current activities and the external environment. Credit unions are expected to consider environmental risk as part of the risk management process including risks arising from the macro-economy and credit union sector specific risks. The board of directors should be cognizant of changes in the external environment when reviewing the appropriateness of the management process.

Supervision

On-going supervision and PRISM on-site engagements outlined in Guiding Principle 6.1 are generally applicable to this section. Specific activities include establishing that:

- adequate risk identification, measurement and evaluation processes are in place;
- regular training is being provided to relevant officers in relation to risk identification, measurement and evaluation;
- the risk management officer and manager ensure that risks are mitigated and managed through regular reviews of the risk register with the involvement of the board of directors; and
- the risk management officer and the board of directors ensure that risks are monitored.

GUIDING PRINCIPLE 6.3. The supervisor determines that risk management strategies, policies, processes and limits are: (a) properly documented; (b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and (c) communicated within the credit union. The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorisation by, the appropriate level of management and the credit union's Board where necessary.

Description and Findings - GUIDING PRINCIPLE 6.3: Section 76B of the 1997 Act, requires that the risk management system of the credit union shall be clearly set out and documented including related tasks and responsibilities within the credit union. Section 55 of the 1997 Act sets out the requirement for the board of directors to review and approve all elements of the risk management system on a regular basis, but at least annually. The review must include assessing the appropriateness of the risk management system, taking account of any changes to the strategic plan, including the credit union's resources or the external environment, and taking measures necessary to address any deficiencies identified in the risk management system.

The Central Bank has issued guidance on risk management and compliance in the *Credit Union Handbook* for the board of directors to ensure that the risk management policy is communicated to all officers of the credit union. Additionally, the Central Bank has indicated that the risk management officer should provide reports on a monthly basis to the board of directors (or risk committee where one exists) and that copies of these reports should be provided to the manager.

The risk management officer is also required to advise the board of directors on any deviations from the risk management policy.

Supervision

On-going supervision and PRISM on-site engagements outlined in Guiding Principle 6.1 are generally applicable to this section. Specific activities include:

- ensuring that management strategies, policies, processes and limits are properly documented, regularly reviewed and updated to reflect changing risk appetites, risk profiles and that they are communicated and applied throughout the credit union; and
- assessing whether the management information provided to the board of directors contains information in relation to any exceptions or deviations from the risk management policy/processes.

GUIDING PRINCIPLE 6.4. The risk management system should be commensurate with the size and complexity of the credit union and its activities.

Description and Findings - GUIDING PRINCIPLE 6.4: Risk Management and Compliance guidance in the *Credit Union Handbook* indicates that credit unions should take the nature, scale and complexity of the business being conducted by the credit union into consideration when establishing governance arrangements, including arrangements in relation to risk management systems, systems and control, the risk management officer, the compliance officer and the internal audit function.

The Central Bank has also indicated that the board of directors should ensure that the risk management officer has adequate time and resources to carry out their function having regard to the nature, scale, complexity and the risk profile of the credit union.

Supervision

On-going supervision and PRISM on-site engagements activities outlined in Guiding Principle 6.1 are generally applicable to this section. The extent and frequency of supervisory on-site review are based primarily on a credit union's impact level as set out in Guiding Principle 18.

Supervisors will use judgment to assess the effectiveness of the RMP having due regard to the risk profile of the credit union. Prior to 2015, there was no scheduled on-site engagement with Low Impact credit unions.

Assessment of GUIDING PRINCIPLE 6: Compliant

Comment: An important and relevant risk management framework has been introduced for the credit union sector in Ireland, and the Central Bank has provided guidance for credit unions on the risk management requirements. Over time, this should elevate the governance structures to ensure the long term viability of the sector with expanded business opportunities and lead to a more mature sector.

To date there has been limited experience on the nature and extent of the implementation of recent risk management requirements other than any material deficiencies noted in the new annual compliance statement. The Temporary Engagement Model for 2015 will result in a narrower, more focused approach which is to be applied to all credit unions based on a number of key metrics. A more comprehensive review of risk management processes will only be applied to a limited number of credit unions, where warranted. For the remaining credit unions, the assessment will include only a limited review, with any substantive testing only completed where considered warranted.

Recommendation: A new comprehensive risk management and governance framework for all credit unions which introduced a number of new requirements and functions has only recently been introduced over a relatively short timeframe. While the Central Bank has engaged with the sector on all recent changes and introduced extensive guidance on the new requirements, it is apparent that these changes are not yet fully understood by the credit union sector and will likely take some time to be effectively implemented. Given the extent of the regulatory changes, the Central Bank should consider expanding its on-site engagements with credit unions to foster greater awareness and understanding of key requirements, formulate expectations and help ensure that any material weaknesses can be appropriately addressed within a suitable timeframe.

The Central Bank may also wish to work with the credit union sector in developing sample tools and/or best practices to supplement their risk management and governance guidance that may help smaller credit unions, in particular to more readily implement suitably scaled approaches.

GUIDING PRINCIPLE 7: CREDIT RISK

Credit risk is generally the most significant risk for cooperative financial institutions. Accordingly, supervisory authorities should ensure that regulated institutions have appropriate policies in terms of their accepted risk in specific undertakings and adequate systems to manage such risks. It is essential that regulated institutions are able to manage their credit portfolios effectively in terms of monitoring the performance of the portfolio and the collection of distressed facilities. The supervisory authority should also focus on ensuring that regulated institutions focus on forms of lending they are capable of undertaking, while avoiding areas that require expertise they do not possess.

GUIDING PRINCIPLE 7.1. Laws, regulations or the supervisor require credit unions to have appropriate credit risk management processes that provide a comprehensive credit union-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the credit union, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.

Description and Findings - GUIDING PRINCIPLE 7.1: Under the 1997 Act credit unions are required to have risk management systems in place that manage and mitigate the risk that credit unions are exposed to, including credit risk. Under section 55 of the 1997 Act, the board of directors is required to approve, review, and update, where necessary, but at least annually, all plans, policies and procedures of the credit union, including lending policies and lending limits. Rules regarding making and approving loans are set out in sections 35 and 36 of the 1997 Act. These include the requirement for the board of directors, credit committee or credit officer to decide on applications for credit, and a Credit Control Committee, to ensure the repayment of loans by members in accordance with loan agreements. The Central Bank has issued guidance on lending best practices, including the need to ensure the implementation of proper and prudent underwriting standards. This includes expectations for appropriate and adequate lending policies and processes surrounding underwriting, including income verification and credit worthiness, assessment and monitoring in relation to credit control and following up on arrears. While the majority of credit union lending is currently personal unsecured lending (over 90%), credit unions undertake other forms of lending, including commercial lending and mortgage lending. The Central Bank has previously indicated that specialist forms of lending, such as commercial lending, are generally considered higher risk and not appropriate for the majority of credit unions given the specific skills and expertise required.

The Central Bank has issued guidance which sets out a number of limits in relation to investments, including counterparty limits for investments. Credit unions are also required to have investment policies in place which should set out limits within which each credit union's investments should be undertaken. Guidance has also been issued regarding authorized investments, investments in State securities and valuation of investments.

Supervision

On-going supervision of credit risk is assessed for all credit unions based on an assessment of the quarterly Prudential Returns and Year End Returns; credit risk management information, including arrears/provision trends; issues raised in internal/external reports; and issues raised in auditors' management letters, including systems and controls issues and related governance issues. KRI alerts are generated if there are significant changes in underlying supervisory ratios. All credit unions are also required to submit an annual compliance statement with Part IV of the 1997 Act to the Central Bank which includes provisions relating to credit risk management. Where a credit union identifies material non-compliance with the requirements of Part IV of the 1997 Act, it must submit a Report of Material Non-Compliance to the Central Bank, including details of how and when the non-compliance will be rectified. In the event of any risk management issues being identified, follow-up action is undertaken as appropriate by the supervisor.

In addition to on-going supervision, credit risk practices are assessed as part of on-going PRISM on-site engagements. These can include meetings with key credit union management personnel, board of directors, BOC members, internal audit and external audit as specified in the PRISM engagement model (see Guiding Principle 18 for details of the PRISM engagement model). Credit risk guidance materials have been developed which set out a number of considerations that supervisors may use when assessing the quality of credit risk practices and compliance to regulatory requirements. These considerations are closely aligned with the requirements set out above, and include:

- reviewing the credit union's risk tolerance statement;
- reviewing the credit risk (lending, investment and provisioning) policies;
- reviewing the credit underwriting procedures and controls;
- evaluating and challenging the adequacy of credit unions' credit risk environment, independent credit approval process and credit administration, measurement and monitoring process;
- analysing the data being presented to, and reviewed by the board of directors, including Credit and Credit Control Committee reports;
- sample testing of loan files to ascertain adherence with policies;
- sample testing of new loans to assess the quality of credit control.

Findings in relation to credit risk are communicated to the credit union's board of directors through the issuance of an RMP setting out any deficiencies found, the mitigating action to be taken and the timeframe for implementation of the mitigating action.

During 2015 credit risk management processes will be assessed, as appropriate, during credit union engagements that are carried out in line with the Temporary Engagement Model for 2015. This will include engagement with Low Impact credit unions. A separate engagement model has been established for credit unions that are supervised by the I&R team.

GUIDING PRINCIPLE 7.2. The supervisor determines that a credit union's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming, identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.

Description and Findings - GUIDING PRINCIPLE 7.2: Credit unions are required to have a risk management system, process and risk management policy to allow it to identify, assess, measure, monitor, report and manage risks including credit risk. The risk management process must identify and mitigate all significant risks to a level consistent with the risk tolerance of the credit union. The board of directors is also required to approve, review and update lending and investment policies at least annually. The functions of the manager include implementing the strategies agreed by the board of directors to the standards set out in the strategic plan or as otherwise required by the board of directors.

Supervision

On-going supervision and PRISM on-site engagements outlined in Guiding Principle 7.1 are generally applicable to this section. Specific activities include:

- evaluating the granularity of the management information received by the board of directors/committees;
- reviewing the minutes of the board of directors for evidence of challenge and/or understanding of the credit risk facing the institution; and
- evaluating credit management structures to ensure there is an appropriate division between the business line and the credit risk divisions.

GUIDING PRINCIPLE 7.3. The supervisory authority should also focus on ensuring that credit unions focus on forms of lending they are capable of undertaking, while avoiding areas that require expertise they do not possess.

Description and Findings - GUIDING PRINCIPLE 7.3: The majority of credit union lending is personal unsecured lending. The Central Bank has indicated that where credit unions undertake other forms of lending such as commercial lending, this should only be undertaken where the credit union has access to the skills and expertise to evaluate and monitor this type of lending. In general, such specialist forms of lending are considered to be high risk and not appropriate for the majority of credit unions given the specific skills and expertise required.

The Central Bank has indicated where a credit union does undertake commercial lending, it should decide on the prudent maximum percentage of the value of the total loans of the credit union to be made in commercial lending and should monitor compliance with this maximum amount by means of a monthly report of the credit committee to the board of directors.

Supervision

Where supervisors have specific concerns about Credit Risk they may impose investment or lending restrictions on the credit union. Investment restrictions are imposed in the context of concerns relating to investment knowledge and process. Lending restrictions are imposed in the context of concerns relating to weakness in governance, credit practices, and systems and controls for lending and credit control.

As an example, based on findings under an FRA the loan underwriting function of a credit union was deemed ineffective due to inconsistent loan documentation quality with files lacking supporting financial information to adequately underwrite the loan. Specific issues were identified with large commercial loans in arrears. As a result, the credit union was restricted from commercial lending.

At the time of the ICURN Credit Union Peer Review approximately 53% of credit unions had some form of lending restrictions. Of the credit unions with lending restrictions, c. 67% had a restriction relating to commercial lending.

Assessment of GUIDING PRINCIPLE 7: Largely Compliant

Comment: The Central Bank has undertaken a range of measures in relation to credit risk in credit unions. These include 1) a program of loan book reviews in 2011; 2) the introduction of lending restrictions where supervisory concerns exist in relation to weakness in governance, credit practices, and systems and controls for lending and credit control; and 3) a program of targeted asset reviews in a number of credit unions with increased risk profiles to determine any shortfall in their capital base.

The Central Bank has also regularly updated its guidance surrounding credit risk management over a number of years. Further modifications to the regulatory framework are intended to strengthen credit union practices, particularly relating to lending when revisions to 1997 Act, along with new regulations, are planned to be introduced at the end of 2015. The Central Bank proposes to update relevant sections of the *Credit Union Handbook* in advance of the new sections of the 1997 Act and regulations are planned to come into effect at the end of 2015.

In 2011, the Central Bank completed a full assessment of individual credit union loan portfolios. As a result of this assessment, it was determined that 66% of credit union needed to make additional provisions. Credit unions were required to address noted deficiencies in accordance with established timeframes.

As set out in the "Credit Union PRISM Risk Assessments Supervisory Commentary" published in May 2014, weaknesses in lending, credit control and credit risk management standards and practices in credit unions have been particularly notable. The commentary indicated that the majority of credit unions visited were required to implement a range of actions designed to remediate risks and substantially improve their lending and credit risk management standards and practices.

Notwithstanding these requirements, the level of arrears and loan loss provisions as a percentage of gross loans has remained high over the past few years relative to international norms. While the current level of arrears partly reflects the impact of the financial and economic downturn in Ireland on the credit union sector and the continued fall in the loan-to-asset ratio, it may also be an indicator of continuing weaknesses in credit underwriting practices.

Table 7

	Dec. 2008	Dec. 2009	Dec. 2010	Dec. 2011	Dec. 2012	Dec. 2013	Dec. 2014
Loans to Assets	52%	48%	44%	41%	36%	32%	29%
Loan Arrears >9 weeks	8%	12%	17%	19%	20%	19%	17%
Loan Loss Provisions	4%	7%	12%	15%	18%	20%	20%

While the level of provisions is slightly higher in smaller credit unions, there are no material differences across all impact levels.

The initial PRISM engagement model is not applied to Low Impact credit unions. Prior to 2015, Low Impact credit unions were subject to supervisory action on a reactive basis which may have resulted in less focus on remediating weak underwriting practices in Low Impact credit unions than in other credit unions.

Recommendation: The Central Bank should consider focusing its attention on key risks, particularly the lending area of credit risk, that have real potential to cause material damages to credit unions and impact longer term viability. Under PRISM, the frequency and extent of on-site supervision activities for credit risk may not allow for sufficient oversight of this key risk area. The Central Bank has indicated that weak lending policies and underwriting standards remain a key concern. Under the Temporary Engagement model introduced for 2015, Low Impact and certain other weaker credit unions will be subject to a risk focused on-site engagement, which will include an assessment of the extent or otherwise of risks posed in terms of viability, potential weakness and/or absence of key policies. Where appropriate, this will include consideration of credit risk policies and practices. RCU has indicated that it is to develop a longer term engagement model for credit unions in 2015 to apply thereafter. Given the inherent risks and continuing high levels of loan arrears as a percentage of total loans, we welcome RCU's intention to refine the longer term engagement model in the future. We recommend this should always include a full on-site review of credit risk for all credit unions, including Low Impact credit unions, and a minimum appropriate level of sampling and testing of actual lending and investment practices.

The Central Bank has recently commenced a review of lending restrictions in the credit union sector; lessons may be learned from this and applied to the longer term engagement model that is currently being developed. It may also wish to consider further refining the approach for lending restrictions to see if these could be applied more rigorously to higher risk credit unions, especially where material outstanding weaknesses and deficiencies persist. This may include restrictions on specific lending, including loan rescheduling and further reductions in lending limits.

Current lending and investment sections of the *Credit Union Handbook* make reference to a number of previously issued publications and guidance. The Central Bank proposes to update relevant sections of the *Credit Union Handbook* in advance of the new sections of the 1997 Act and new regulations which are planned to come into effect at the end of 2015. It may be helpful at that stage to fully consolidate all current lending and investment guidance into separate reference documents that are more functional and cohesive.

GUIDING PRINCIPLE 8: PROBLEM ASSETS, PROVISIONS AND RESERVES

Regulated institutions must have adequate policies and processes for managing problem assets and provision appropriately for such assets. It is essential for supervisory authorities to ensure that regulated institutions are adequately provisioned for troubled/problem loans and other impaired assets. Provisions should also be considered for untroubled loans to reflect historical loss experience and changes in economic conditions that may affect the quality of the loan portfolio as a whole. Some provision may be required for contingent liabilities, depending on the probability of a corresponding cash outflow.

GUIDING PRINCIPLE 8.1. *Laws, regulations or the supervisor require credit unions to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require regular review by credit unions of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.*

Description and Findings - GUIDING PRINCIPLE 8.1: Under the 1997 Act, credit unions are required to cause proper accounting records to be kept on a continuous and consistent basis and to disclose with reasonable accuracy and promptness a true and fair view of the state of the financial affairs of the credit union. In order to meet these requirements credit unions must have appropriate policies for identifying problem assets and must regularly review their problem assets, provisioning and write-offs. Under section 55(1)(o)(i) of the 1997 Act the board of directors of a credit union is required to approve, review and update their lending policies at least annually.

This obligation has been supplemented by the Central Bank in the Guidance Note on Credit and Credit Control for Credit Unions (October 2007). This Guidance Note states that the Central Bank expects credit unions to have a clearly documented provisioning policy in relation to individual loan types, including single or lump sum repayment loans in arrears, rescheduled loans and loans in arrears where a transfer of shares is applied against the loan balance.

The Guidance Note also states that, where credit unions undertake additional types of lending such as commercial lending, the performance of such loans should be subject to regular monitoring, appropriate to the scale and complexity of the activity. The Central Bank has also indicated that atypical lending, such as single or lump sum repayment loans, should be assessed individually to determine the need for any provision for bad and doubtful debts.

Credit unions are also required to develop, implement, document and maintain a risk management system with such governance arrangements and systems and controls to allow it to identify, assess, measure, monitor, report and manage the risks which it is, or might reasonably be, exposed to.

The Central Bank has issued specific requirements in relation to provisioning Section 35 Regulatory Requirements for Credit Unions (October 2013). These requirements came into effect on 1 November 2010 and were revised in October 2013.

Under these requirements credit unions must ensure:

- that they review their total loan portfolios on a quarterly basis to verify the adequacy of the provision for bad and doubtful debts;
- that any resulting adjustments to the provision are incorporated into their accounts; and
- that a full review of the bad debt provisions, including the provisions held against rescheduled loans, is undertaken as part of the year-end annual accounts preparation and audit process.

These requirements also require credit unions to hold a minimum provision of 20% for a loan that has been rescheduled. Where a rescheduled loan fails to perform in accordance with its new terms the Central Bank has set out additional provisions that must be made based on the combined weeks in arrears.

Credit unions are required to prepare their financial accounts in accordance with local GAAP or with IFRS in accordance with the requirement set out in section 110(f) of the 1997 Act which requires that in determining how amounts are presented within items in the income and expenditure account and balance sheet, the directors of a credit union must have regard to the substance of the reported transaction or arrangement, in accordance with GAAP or practice.

GUIDING PRINCIPLE 8.2. The supervisor determines that the credit union’s system for classification and provisioning takes into account off-balance sheet exposures.

Description and Findings - GUIDING PRINCIPLE 8.2: Credit unions report on Off-Balance sheet items as part of the quarterly Prudential Return facilitating monitoring by supervisors.

In practice, less than 1% of credit unions have reported Off-Balance Sheet Items (including contingent liabilities). The most significant Off-Balance Sheet amounts reported represented less than 1% of the credit union’s assets. Therefore, Off-Balance Sheet exposures are not currently material to credit union’s system for classification and provisioning.

GUIDING PRINCIPLE 8.3. The supervisor determines that credit unions have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.

Description and Findings - GUIDING PRINCIPLE 8.3: Credit unions are required to have lending policies (which would include a provisioning policy) and investment policies which should reflect the criteria and process relating to write downs and write offs for loans and investments. The Central Bank has indicated in guidance that loans deemed irrecoverable by the board of directors on the advice of the credit control committee, should be written off in accordance with the procedure laid down in the credit control policy and that such loan write-offs should be made as they arise during the year and not left to the financial year-end.

Credit unions are required, at least quarterly, to review their total loan portfolios to verify the adequacy of the provision for bad and doubtful debts.

In assessing credit, capital and market risk supervisors may be informed by the Central Bank’s “Environmental Risk Assessment - Macro Economic Risk.” Where a supervisor is of the opinion that provisions and write offs are not being allocated in a timely manner, the supervisor can request the credit union to review its lending or investment policies and ensure that they are fit for purpose. In relation to lending, supervisors pay particular attention to loans that are over 53 weeks in arrears but have not been written off. Credit unions that hold large amounts of these loans have been requested to review this category for potential write-offs.

GUIDING PRINCIPLE 8.4. The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g. if the supervisor

considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the credit union to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.

Description and Findings - GUIDING PRINCIPLE 8.4: Credit union lending is predominantly comprised of unsecured personal loans. Supervisors assess credit union provisions based on information provided in the quarterly Prudential Return, the Year End Return and year end accounts to assess whether credit unions are adequately provisioned for troubled/problem loans and other impaired assets. KRI alerts are generated if there is a significant move in underlying KRIs such as Arrears > 9 weeks, Total Provisions for Gross Loans in Arrears > 9 weeks and % of Total Loans Rescheduled. In addition to this on-going supervision further analysis is undertaken based on information provided in the Year End Return and year end accounts. An assessment of credit, market and capital risk is undertaken as part of on-site engagements as appropriate, which may include meetings with key credit union personnel. As part of this process lending policies and investment policies are reviewed and where material deficiencies are identified, an RMP is issued to the credit union setting out deficiencies found, the mitigating action to be taken and the timeframe for implementation of the mitigating action.

Supervisors may also require a credit union to undertake a loan book review to assess the adequacy and timeliness of provisioning depending on the particular circumstances. This may be undertaken by the credit union or by an external party either nominated by the credit union or appointed by the Central Bank. Where such a review indicates that provisioning is not adequate a credit union is required to reflect additional impairments arising from an asset review in its financial statements. These impairments may lead to a shortfall in reserves, resulting in a requirement for additional regulatory action. In such cases the Central Bank may issue a regulatory direction to a credit union directing it to restore its reserves position in order to meet regulatory reserve requirements.

During an on-site FRA, a limited sample of loans is reviewed in order to ensure that the credit policy (including the provisioning policy) is being adhered to, that provisioning levels held appear adequate and that loan underwriting practices are robust and consistent. Provisioning on rescheduled loans may be assessed taking account of specific provisioning requirements under the 1997 Act. A credit union is requested to submit a full share and loan listing in advance of an FRA and the supervisors will select their sample from this information. The credit (including provisioning) and credit control policies will be reviewed before the on-site engagement; the supervisors will challenge the credit union during the meeting stage and look for evidence of adherence to the policies while on-site.

As part of the year-end audit external auditors are expected to take into consideration the level of risk inherent in the loan book of the credit union with particular emphasis on the adequacy of bad debt provisions. In this regard RCU issues a year end circular to auditors which draws their attention to the audit of accounting estimates highlighting that in forming their opinion on the adequacy of provisions that they need to be mindful of practices than can have the effect of understating provisions.

In relation to investments the Central Bank has issued guidance on accounting for investments Guidance Note for Credit Unions on Matters Relating to Accounting for Investments and Distribution Policy (April 2009) which sets out guidance on the valuation of investments. The Central Bank has indicated in this guidance that in most cases the lower of cost and net realisable value (NRV) will be the most appropriate valuation method for investments. The use of this method will assist in ensuring that credit unions identify and monitor problem assets on an on-going basis. The external auditor also reviews the investment valuations held at year-end during their year-end audit. Credit unions are required to have investment policies that are reviewed, updated and approved by the board of directors at least annually. The Central Bank has issued guidance, contained in the Investments Chapter of the *Credit Union Handbook*, on what investment policies should cover, including the process for monitoring the value of investments and the accounting treatment adopted for the valuation of investments.

In relation to fixed assets, the valuation of fixed assets is dealt with under accounting standard FRS 11 which sets out the principles and methodology for accounting for impairments of fixed assets. The majority of fixed assets in a credit union relates to their premises. RCU also issues guidance to credit unions on the treatment of impaired fixed assets in an annual circular on the Credit Union Financial Year-End Approach.

GUIDING PRINCIPLE 8.5. Laws, regulations or the supervisor establish criteria for assets to be: (a) identified as a problem asset (e.g. a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and (b) reclassified as performing (e.g. a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).

Description and Findings GUIDING PRINCIPLE 8.5: Credit unions are required to report on loan arrears as part of the quarterly Prudential Return. Credit unions report on loans in categories based on the number of weeks in arrears. For each arrears category credit unions indicate the % provision and monetary amount of provision provided.

Many credit unions use Resolution 49 of the ILCU as the basis for the calculation of the provision for bad and doubtful debts. This is a process whereby provisions are applied based on the number of weeks that a loan has been in arrears (same time bands as the Prudential Return). The Central Bank has specified clear guidance regarding the use of Resolution 49 for provisioning purposes to the effect that it must not distort the appropriate level of provisioning.

The “Section 35 Regulatory Requirements for Credit Unions” require that a minimum provision of the higher of 20% of the net loan or any provision that existed at the time of reschedule be maintained for rescheduled loans. Credit unions are also required to apply additional provision for rescheduled loans that fail to perform in accordance with the new terms. This is based on graduated provisions based on the combined weeks in arrears (i.e. the number of weeks the loan was in arrears at the time of reschedule plus the number of weeks the loan is in arrears since the loan was rescheduled).

The Central Bank has undertaken a number of loan book review programs. Between August 2010 and March 2011, as part of the supervisory actions committed to under the Troika Programme for Ireland, 401 credit unions were subject to inspections, focusing on loan book provisions. Of the 401 credit unions inspected, 66% needed to make additional provisions for bad and doubtful debts based on the outcome of the inspections. All credit unions were provided with action plans arising from their inspection. These plans set out the provisioning changes and process changes that credit unions had to undertake to remedy the deficiencies noted by the Inspectors and the timeframes for undertaking these actions.

Since 2012 a program of asset reviews, focusing on individual credit unions with increased risk profiles, has been undertaken. The primary objective of the inspections was to establish the adequacy of the credit unions provisions for bad and doubtful debts at the time of their inspection and to identify indicative levels of additional provisions to be made by the credit unions, if any. Further, certain credit unions with increased risk profiles may be subject to an asset review by an independent external consultant appointed by RCU. These reviews are commissioned in line with section 90 of the 1997 Act under a framework agreement for outsourced inspections. The program of work to be undertaken as part of these asset reviews is agreed in advance between RCU and the consultants to ensure consistency in terms of the methodology to be used and the output from the inspections.

RCU has identified and selected a number of credit unions to be subject to such asset reviews since 2012. Credit unions were selected on the basis of the information contained in the quarterly Prudential Returns and prioritized taking account of particular financial information. The primary focus of these asset reviews was to determine any shortfall in the reserves of the selected credit unions. The work undertaken to make this determination includes an assessment of the adequacy of loan provisioning requirements, the valuation of the investment portfolio and an assessment of the carrying value of the fixed assets of the credit unions. To date, a total of c. 70 asset reviews have been undertaken as part of this program with a view to quantifying impairment levels, resultant impact on reserves and identifying those credit unions that require specific intervention or restructuring actions.

GUIDING PRINCIPLE 8.6. Provisions should also be considered for untroubled loans to reflect historical experience and changes in economic conditions that may affect the quality of the loan portfolio as a whole.

Description and Findings GUIDING PRINCIPLE 8.6: Credit unions are required to prepare their financial accounts in accordance with local GAAP or with IFRS in accordance with the requirement set out in section 110(f) of the 1997 Act. FRS 26 Financial Instruments: Recognition and Measurement is harmonized with the requirements of International Accounting Standards (IAS) 39. This standard's core principle with respect to impairment is that impairment provisions are recognized only when losses are incurred and not before then. This approach will change with the adoption of IFRS 9, which is due in January 2018 and will replace IAS 39; this will represent a move away from the current "incurred loss" approach toward an "expected" loss approach.

It is recognized that loss factors will always exist in a loan book which have not yet been identified but which give rise to a potential loss i.e. an Incurred But Not Reported (IBNR) provision applied to the performing loans in a loan book. The application of the IBNR provision is the approach taken during asset reviews commissioned by the Central Bank and the approach adopted by some credit unions. The Central Bank has indicated in previous consultations that a provisioning framework would include the requirement for credit unions to ensure their provisioning practices include an assessment of IBNR exposures whereby historical experience is used to estimate the losses in the loan book that have not yet materialized and to set aside an appropriate amount of provisions for such losses.

Assessment of GUIDING PRINCIPLE 8: Compliant

Comment: This is an area on which the Central Bank has focused considerable attention since the financial crisis, although the risks to the sector posed by poor underwriting and inadequate provisioning had previously been identified as an issue. The historical legislation gave the then regulator limited powers, although these were supplemented as far as was then possible, by the issuance of Guidance Notes, such as the *Guidance Note on Credit and Credit Control for Credit Unions (October 2007)*, references in the annual circulars to credit unions and credit union auditors highlighting the importance of ensuring the adequacy of bad debt provisions, and a program of targeted asset reviews. The post-crisis legislation has provided the Central Bank with a robust framework of powers and certain provisioning requirements have already been introduced.

There are numerous examples of the impact of the Central Bank's work in this key area. Some illustrate the positive improvements that can be achieved by supervisors and others exemplify the serious damage caused to individual institutions. Most have their root cause in poor-quality underwriting and/or unrealistic asset valuations, and related inadequate provisioning. Some examples are referred to below:

- During the course of a risk assessment the supervisor determined that there was no regular, formal internal review by a credit union on the adequacy of its loan provisions and that there were insufficient credit quality assurance reviews for new loans. An RMP was issued to the credit union setting out the actions required, including carrying out a quarterly review of the adequacy of the credit union's loan provisions. The credit union confirmed that a loan book review would be conducted and that reviews would be presented to the board of directors on a quarterly basis. The credit union subsequently submitted its revised lending policy to RCU.
- In another instance an independent asset review was submitted to the Central Bank which identified a significant additional loan provision requirement and the potential for impairment of the premises (subject to review of the projections and an updated market valuation). The credit union subsequently reflected these provisions in its financial statements. Subsequent to the report the credit union carried out additional "value in use" work on the main premises which resulted in a write down of the valuation of the credit union's premises that was reflected in the credit union's financial statements.
- In the 4 credit unions where resolution actions have been taken to date, issues in relation to quality of the loan book, provisions and asset valuations were significant factors in contributing to the financial deterioration that resulted in the resolution actions being taken by the Central Bank.

Intensive work by the Central Bank has contributed to the overall level of provisions in the sector increasing significantly in recent years. For example, provisions as a percentage of loans increased from 12% in December 2010 to 20% in December 2014.

The Central Bank has begun the initial phase of developing a provisioning framework for credit unions with the objective of formalizing the position in the following areas:

- ensuring recognition of loan losses as early as possible within the context of accounting standards;
- adoption of a sufficiently conservative and comparable approach to the measurement and making of impairment provisions; and
- disclosures to support members' understanding of the performance of the loan book and the credit union's credit risk management practices.

This will include informal and formal consultation with the sector, leading to a consultation paper on provisioning, intended for the end of 2015. The Central Bank has indicated in previous consultations that a provisioning framework would include the requirement for credit unions to ensure their provisioning practices include an assessment of IBNR exposures whereby historical experience is used to estimate the losses in the loan book that have not yet materialized and to set aside an appropriate amount of provisions for such losses.

Credit unions will also be required to apply a number of material changes in their accountancy practice as arising from the approach to be introduced by IFRS 9, and the new approach now introduced by FRS 102. Notably, FRS 102 contains requirements for credit unions including the following:

- requirement for objective evidence that impairment exists prior to making provisions, and
- requirements in relation to calculation of provisions, (e.g. one suggested method for impairments is based on discounted future cash flows).

The Central Bank has identified poor underwriting as a key area of focus in Irish credit unions and described a number of serious instances during the ICURN Credit Union Peer Review; in parallel it has also identified, and exemplified, serious failures and unsatisfactory approaches to provisioning and recognition of losses. These are significant issues that credit unions must address if they are to be solvent at all times and ensure the protection of members' savings.

Recommendation: The Central Bank has undertaken important supervisory work in establishing the true state of credit union loan books, through asset reviews and PRISM on-site engagements in selected credit unions, and in laying the foundations for higher-quality, disciplined, lending. It also provides useful, practical, guidance to credit unions and audit firms regarding the correct approaches to be taken to provisioning and the prudent management of non-performing or impaired loans. In view of the key importance of the latter issue, we recommend that the Central Bank maintains and, if possible, increases its focus on providing guidance and education to the sector in these areas.

GUIDING PRINCIPLE 9: Large Exposures

Regulated institutions should have appropriate and adequate policies and processes around large exposures (concentration risk). The supervisory authority should set rules around the definition and limit of large exposures to which regulated institutions can be exposed and should have the power to intervene should these be breached.

GUIDING PRINCIPLE 9.1. Laws, regulations or the supervisor require credit unions to have policies and processes that provide a comprehensive credit union-wide view of significant sources of concentration risk. Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.

Description and Findings GUIDING PRINCIPLE 9.1: Section 35 of the 1997 Act contains requirements in relation to the making of loans, including limits of the maximum loan a credit union can make to an individual borrower. Section 35(2F) of the 1997 Act provides that a credit union shall ensure that it has appropriate processes, procedures, systems, controls and reporting arrangements to monitor compliance with the requirements under section 35. The current regulatory framework includes lending limits on the maximum exposure a credit union can have to a member (greater of €39,000 or 1.5% of total assets of the credit union). Credit unions are also required to have lending policies which should set out the credit union's lending limits, including concentration limits. The large exposure limit for lending includes contingent liabilities and other off-balance-sheet items. Additionally, the Central Bank has provided guidance on credit union investments which sets out limits on exposures to specified classes of investments and limits on the percentage of total investments which can be invested in a single institution (25% of total investments).

Credit unions are also required to have investment policies which should set out the credit unions investment limits, including class and concentration limits. The Investments Chapter of

the *Credit Union Handbook* includes guidance on the minimum content of investment policies. This guidance indicates that investment policies should set out the strategy to manage 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.

This should include, among other things:

- how the credit union will manage market risk, including specifically listing institutions, issuers and counterparties that may be used, or criteria for their selection, and the limits on the amounts that may be invested with each; and
- how the credit union will manage the concentration risk that can result from dealing with a single or related issuers or holding investments with similar characteristics like maturities.

GUIDING PRINCIPLE 9.2. The supervisor determines that a credit union's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the credit union's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the credit union's policies and processes require all material concentrations to be regularly reviewed and reported to the credit union's Board.

Description and Findings GUIDING PRINCIPLE 9.2: As part of its obligations under section 55 of the 1997 Act, the board of directors of a credit union must approve, review and update where necessary, but at least annually, lending policies, including lending limits.

In relation to lending, the Central Bank has indicated in guidance that a credit policy should clearly state and define a number of matters, including:

- the maximum amount which may be lent to a member and the maximum amount of commercial lending as a percentage of the total loan book, as determined by the board of directors, and
- systems of control to ensure that a breach of the maximum loan limit does not occur through connected borrowers and that concentration of risk does not occur through over-exposure to a small number of large and/or connected borrowers.

In addition to on-going supervision, risk management policies and processes are assessed as part of on-site engagements which may include meetings with key credit union personnel. Each on-site engagement involves reviewing the policies for investments, credit and liquidity and any missing items will be included in an RMP setting out the deficiencies found, the mitigating action to be taken and the timeframe for implementation of the mitigating action.

The Central Bank has indicated in the Risk Management Chapter of the *Credit Union Handbook* that the risk management officer should provide monthly reports to the board of directors (or risk committee where one exists) covering areas including likely or actual deviations from risk tolerance levels or established systems and controls. Guidance also indicates that the compliance officer should provide reports on the compliance programme to the board of directors and the manager on a quarterly basis which would, *inter alia*, identify any compliance breaches.

Credit unions are required to submit an annual compliance statement to the Central Bank which provides information on a credit union's compliance with the requirements of Part IV of the 1997 Act, including the provisions relating to risk management. Where a credit union identifies material non-compliance with the requirements of Part IV of the 1997 Act, it must submit a Report of Material Non-Compliance to the Central Bank, including details of how and when the non-compliance will be rectified. In the event of risk management issues being identified, follow-up action is undertaken as appropriate by the supervisor.

GUIDING PRINCIPLE 9.3. In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case by case basis.

Description and Findings GUIDING PRINCIPLE 9.3: RCU has provided a definition of connected borrowers in Guidance on the Year End Return which states that the following should be considered as connected borrowers:

- (a) Two or more, natural or legal persons between whom there is no relationship of control but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties; or

(b) Where two or more, natural or legal persons are in a relationship of control, the credit union should make an assessment as to whether those in the relationship of control should be regarded as a single risk because they are so interconnected that if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties.

GUIDING PRINCIPLE 9.4. Laws, regulations or the supervisor set prudent and appropriate requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. “Exposures” for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that management monitors these limits and that they are not exceeded on a solo or consolidated basis.

Description and Findings GUIDING PRINCIPLE 9.4: Credit unions provide information on their lending and investment exposures as part of the quarterly Prudential Return which facilitates off-site analysis by supervisors of credit union exposures and adherence to limits. Additionally supervisors may review lending and investment policies to assess whether they are appropriate for a credit union.

Where the Central Bank has concerns relating to a credit union’s lending exposures it may issue a lending restriction to restrict the size or type of lending which the credit union may undertake. The Central Bank may also take a number of other actions in the case of breaches of prescribed limits including, issuing an RMP, the imposition of administrative sanctions or the issuance of regulatory directions.

Assessment of GUIDING PRINCIPLE 9: Compliant

Comment: The Central Bank treats concentration risk with great caution. Historically it has resulted in a number of seriously adverse outcomes in individual credit unions and the sector is now thought to be very risk-averse in this area; however, there can be no guarantee that this caution would persist in a more buoyant economy. In order better to address this risk, the Central Bank has proposed changes (in CP88) to the regulatory framework:

- a definition of “large exposure” will be introduced into the 1997 Act and the Central Bank will be able to make regulations on requirements and limits for large exposures (loans of a credit union to a borrower or group of borrowers who are connected);

- the maximum exposure a credit union may have to a borrower, or a group of borrowers who are connected, will be up to the greater of €39,000 or 10% of the credit union's regulatory reserve;
- if, in an exceptional case, an exposure exceeds the large exposure limit set out in the lending regulations for credit unions, that credit union must hold the amount of the exposure that is in excess of the limit in a realised reserve until such time as the exposure no longer exceeds the limit;
- concentration limits are prescribed for certain categories of lending, including commercial lending, and
- the Central Bank will have the power to set investment limits in regulations and, in line with existing Guidance, credit unions will not be permitted to make an investment with a counterparty which would cause the investments with that counterparty to exceed 25% of the credit union's investments. The draft regulations also reflect existing investment concentration limits and introduce concentration limits for investments in other credit unions and investments in shares in Industrial and Provident Societies.

Supervisors use the analysis of credit union Prudential Returns as a key tool in monitoring concentration risk. In practice they now identify few breaches, but historically supervisory analysis has been central to the identification of extremely serious lending errors in a number of credit unions which were then appropriately resolved.

One of the principal challenges for the Central Bank is that some credit union board of directors do not understand the risks posed by large exposures and are unable to set their own specific risk appetites. While policies exist, their application in day-to-day business is a challenge for some credit unions. The Central Bank is addressing this issue by working to promote good practice, particularly in its 2015 engagement with credit unions.

The Central Bank has taken steps commensurate with its concerns regarding lending exposure by issuing lending restrictions to restrict the size or type of lending which the credit unions concerned may undertake. At the time of the ICURN Credit Union Peer Review 35% of all credit unions have a restriction on commercial lending activity while 52% of all credit unions have a restriction on the largest loan that can be issued. In February 2015 the Central Bank commenced a lending restriction review whereby credit unions that are subject to a lending restriction, but are satisfied that they have made the necessary improvements and have embedded these improvements in robust risk sensitive lending practices, may apply for a review of their lending restriction.

In practice, less than 1% of credit unions have reported Off-Balance Sheet items (which include contingent liabilities). The most significant Off-Balance Sheet amount reported by any credit union represented less than 1% of its assets. In one or two instances a credit union has a small lease but this is very unusual. Contingent liabilities are rare and invariably not-material, although supervisors will investigate the exact circumstances where there is reference to such liabilities in the audit report.

GUIDING PRINCIPLE 10: CONFLICTS OF INTEREST AND RELATED PARTY EXPOSURES

The supervisory authority should have the power to establish rules to control conflicts of interest and related party exposures. It should have in place powers that permit it to intervene where such rules are breached. Related party transactions should be required to be undertaken at arm’s length, and there should be rules that require disclosure and reporting of such transactions.

GUIDING PRINCIPLE 10.1. Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of “related parties.” This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis¹⁸.

Description and Findings - GUIDING PRINCIPLE 10.1: Section 69 of the 1997 Act sets out provisions relating to conflicts of interest which require that officers of a credit union, including the members of the board of directors, shall at all times ensure that individually and collectively they act in a manner free from conflicts of interest. Credit unions are also required to have a conflicts of interest policy for identifying, managing and resolving conflicts of interest and this policy must be reviewed and updated by the board of directors at least annually (the Central Bank has provided guidance in the Governance Chapter of the *Credit Union Handbook* on the minimum content of a conflicts of interest policy).

In addition, the chair of the credit union has a specific responsibility to ensure that conflicts of interest are appropriately managed by the board of directors.

¹⁸ Related parties can include, among other things, members of the credit union’s board of directors, management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

In particular:

Section 69 sets out requirements for credit unions and credit union officers in relation to the management and resolution of conflicts of interest. Section 69(10)(b) of the 1997 Act extends the management of conflicts beyond officers to other related parties, stating that for the purposes of section 69, an officer of a credit union shall be regarded as connected with a particular body if the officer has an interest in the body, whether directly or indirectly and whether as a member, director, employee, shareholder or otherwise. Related parties can include, among other things, the members of the credit union's board of directors, management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies;

Section 69(4) specifically provides that an officer of a credit union shall not, in any manner, directly or indirectly, participate in the consideration or determination of any matter which he or she, or a body with which he or she is connected, has a pecuniary interest or other conflict of interest or where a reasonably perceived conflict of interest exists and, accordingly, an officer shall withdraw from any meeting or part of the meeting during which such a matter is to be considered or determined.

The Governance Chapter of the *Credit Union Handbook* sets out the following:

“In identifying the circumstances which constitute or may give rise to a conflict of interest, credit unions should ensure that the following are taken into account at a minimum:

- whether an officer is likely to make a financial gain, or avoid a loss as a result of their position in the credit union;
- any interest that the officer may have in the outcome of a contract, transaction, and/or arrangement;
- the business or body that the officer is involved in or connected with and whether conflicts of interest may arise from that involvement, and
- the receipt of any inducement by the officer.”

The guidance also states that “every officer of a credit union shall identify all potential conflicts between his or her own interests and the interests of the credit union and shall take all necessary steps to ensure his or her role in the credit union is not influenced by any other interest.” The definition of an officer of a credit union includes members of the board of directors.

The 1997 Act and the Central Bank (Supervision and Enforcement) Act 2013 provide the Central Bank with powers to make regulations in relation to related party exposures including prescribing a definition of related parties. CP88 contains proposals for such regulations (see Guiding Principle 10.3 below).

GUIDING PRINCIPLE 10.2. The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the credit union’s Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.

Description and Findings - GUIDING PRINCIPLE 10.2: The 1997 Act contains provisions in relation to loans to officers, including a requirement that loans to officers be approved by a special committee which consists of a majority of the board of directors and at least one member of the credit committee but cannot include the applicant for the loan. Credit unions are required to report on loans to officers on returns submitted to the Central Bank. Accounting standards include requirements in relation to related party disclosures for credit unions’ audited accounts. The 1997 Act and the Central Bank (Supervision and Enforcement) Act 2013 also provide the Central Bank with the power to prescribe regulations in relation to related party exposures.

Credit unions are required to submit an annual compliance statement to the Central Bank which includes information on a credit union’s compliance with the requirements of Part IV of the 1997 Act relating to conflicts of interest. Where a credit union identifies material non-compliance with the requirements of Part IV of the 1997 Act, it must submit a Report of Material Non-Compliance to the Central Bank, including details of how and when the non-compliance will be rectified.

In addition to on-going supervision, PRISM on-site engagements include an assessment of governance risk, which may include meetings with key credit union personnel and in the course of such engagements, a supervisor may review processes to determine whether:

- loans to officers are approved by a special committee as set out in section 36 of the 1997 Act – this should be evidenced in the board of director materials;
- there is an adequate conflicts of interest policy and register in place; and
- members of the board of directors exempt themselves from decisions where a conflict of interest arises – this should be evidenced in the minutes of the board of directors and the conflicts of interest register.

GUIDING PRINCIPLE 10.3. *Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.*

Description and Findings - GUIDING PRINCIPLE 10.3: The regulatory framework does not currently contain limits for exposures to related parties but the 1997 Act and the Central Bank (Supervision and Enforcement) Act 2013 do provide for the introduction of a definition of related parties and the introduction of requirements and on lending to related parties. Although the proposals in CP88 provide a definition of related parties and set out the proposed requirements on the governance of lending to related parties limits on related party lending are not proposed at present, in recognition of the community based nature of the sector and the potential impact this may have on the implementation of such limits.

The proposed regulations in CP88 define a related party and also contain draft regulations with regard to controls for related party lending. These stipulate that a credit union shall not make a loan to a related party on more favorable terms than a loan to a non-related party. In addition, the proposed regulations indicate that related party lending shall be subject to additional oversight including being subject to prior approval in writing by the board of directors (or subcommittee of the board of directors established to deal with related party lending). Those with conflicts of interest shall be excluded from the approval process and a credit union must report on related party loans monthly in writing, to the board of directors.

GUIDING PRINCIPLE 10.4. *The supervisory authority should have in place powers that permit it to intervene where such rules are breached.*

Description and Findings - GUIDING PRINCIPLE 10.4: The regulatory framework contains a number of requirements relating to conflicts of interest and loans to officers. Where such requirements are breached the Central Bank has a number of powers to intervene including, the issuance of an RMP, the imposition of administrative sanctions and the giving of regulatory directions.

GUIDING PRINCIPLE 10.5. *Related party transactions should be required to be undertaken at arm's length, and there should be rules that require disclosure and reporting of such transactions.*

Description and Findings - GUIDING PRINCIPLE 10.5: Under the 1997 Act, an officer cannot be involved in the approval of a loan they have applied for. Additionally, section 69(4) of the 1997 Act provides that an officer of a credit union shall not, in any manner, directly or indirectly, participate in the consideration or determination of any matter which he or she, or a body with which he or she is connected, has a pecuniary interest or other conflict of interest or where a reasonably perceived conflict of interest exists and, accordingly, an officer shall withdraw from any meeting or part of the meeting during which such a matter is to be considered or determined.

Credit unions are required to report on loans to officers on the quarterly Prudential Return and the Year End Return. Credit unions report on the number and amount of loans to officers of the credit union as part of the Prudential Return, while any loans to officers which are in arrears are also identified in the Prudential Return. A more detailed breakdown of loans to officers, including frequency of repayments etc., is provided on the Year End Return. FRS 8 also sets out requirements in relation to related party disclosures for credit unions' audited accounts.

Assessment of GUIDING PRINCIPLE 10: Compliant

Comment: This is an area to which the Central Bank has given particularly close attention because of specific characteristics of the Irish credit union sector, notably its very strong focus on community. The Central Bank has recognized that the 1997 Act provisions require some enhancement but has sought to balance changes with the sector's characteristics, in particular by omitting earlier proposals to introduce an overall limit on related-party lending and in revising the definition of "family." At the same time, the Central Bank has sought to enhance the governance requirements in this area and to introduce more transparency than accounting regulations alone provide by requiring credit unions to disclose details of related party lending in their annual accounts. Additionally, it is proposed that in the future the Prudential Return shall include loans to all related parties rather than to officers alone, as at present.

Generally, individual supervisors have used routine data analysis as an effective tool for identifying conflicts of interest and related-party exposures and then to follow-up such issues with the credit unions concerned. The following are examples of effective supervision in these areas:

As part of the review of the 2013 Annual Return, a supervisor identified that the person appointed to the statutory risk management and compliance officer functions in a credit union was related to another staff member, which could give rise to potential conflicts of interest. An RMP was issued to the credit union requiring that the credit union board of directors reconsider the appointment to the risk management and compliance functions to ensure adherence to the legislative provisions of independence and freedom from influence. The credit union subsequently advised RCU that the two roles had been assigned to another party. RCU arranged a meeting to confirm that the new appointee was free from conflicts of interest and indeed capable of undertaking his statutory roles;

Credit unions report on the number and amount of loans to officers of the credit union as part of the Prudential Return while any loans to officers which are in arrears are also identified in the Prudential Return. An on-site examination of the circumstances reported, identified instances of non-compliance with a credit union's own lending policy and legislative requirements in respect of a number of officers' loans reviewed:

- loans to officers were not supported by proof of repayment capacity, and
- members of the credit committee were involved in approval of loans to themselves, presenting a clear conflict of interest.

The credit union was required, under an RMP to consider all loan applications, including officer's loans, in accordance with its own lending policy and legislative requirements set out in section 36 of the 1997 Act. The credit union confirmed in writing that the RMP action had been implemented.

GUIDING PRINCIPLE 11: INTEREST RATE RISK AND MARKET RISK

Regulated institutions must have policies and processes in place to manage interest rate risk to which regulated institutions may be exposed. In particular, supervisory authorities should be attuned to the interest rate risk of fixed rate lending portfolios.

Credit unions in Ireland are mainly funded by members' shares and any dividend paid on those shares is discretionary. Interest-bearing deposits are relatively uncommon and represent less than 3% of members' total savings. At the same time, credit unions in Ireland have no significant levels of fixed rate lending. These specific factors have the combined effect of creating an environment where credit unions are not currently exposed to material interest rate risk and market rate risk.

GUIDING PRINCIPLE 11.1. Laws, regulations or the supervisor require credit unions to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive credit union-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The supervisor determines that the credit union's strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the credit union, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the credit union's changing risk profile and market developments.

Description and Findings GUIDING PRINCIPLE 11.1: The regulatory framework prescribes limits on longer term lending, limits on the maturity of investments, and a limit on the proportion of savings that can be held as deposits. The 1997 Act prescribes limits on longer term lending, limits on the maturity of investments and a limit on the proportion of savings that can be held as deposits which also serve to control elements of interest rate risk. The Central Bank has also issued guidance on investments by credit unions in the Guidance Note on Investments by Credit Unions (October 2006) which includes limits on maturities of investments made by credit unions. The changes proposed by CP88, once finalized and implemented, will provide limits generally equivalent to those presently in force.

Credit unions are required to have a risk management system to identify, assess, measure, monitor, report and manage risks. The board of directors is required to approve, review and update its asset and liability management policies at least annually. The Central Bank has issued detailed guidance in the *Credit Union Handbook* on what the asset and liability management policy should cover at a minimum, which includes the process for measuring and monitoring risks arising from asset and liability mismatches. Credit unions are required to submit an annual compliance statement with Part IV of the 1997 Act to the Central Bank, which includes information on the board of director's compliance with obligations to review, approve and update policies, such as asset and liability management policies.

GUIDING PRINCIPLE 11.2. The supervisor determines that a credit union’s strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the credit union’s Board. The supervisor also determines that management ensures that the strategy, policies and processes are developed and implemented effectively.

Description and Findings GUIDING PRINCIPLE 11.2: Under the 1997 Act, the board of directors is required to implement a risk management process that ensures that all significant risks are identified and mitigated to a level consistent with the risk tolerance of the credit union. The board of directors is required to approve, review and update liquidity management policies, investment policies, asset and liability management policies and the risk management policy at least annually. The board of directors is also required to review and approve all elements of the risk management system at least annually to assess its appropriateness.

The Central Bank has provided guidance on the minimum content of the liquidity management policy and the asset and liability management policy in the Liquidity Chapter of the *Credit Union Handbook*.

All credit unions submit financial statements annually to the Central Bank. These documents are reviewed by the relevant supervisor in line with the impact category of the credit union and any issues, such as the level of a proposed dividend payment, may be raised and, where appropriate, challenged, with the credit union. Credit unions are also required to submit an annual compliance statement with Part IV of the 1997 Act to the Central Bank, which includes information on credit unions’ obligations to review, approve and update policies, such as asset and liability management policies. Where a credit union identifies material non-compliance with the requirements of Part IV of the 1997 Act, it must submit a report to the Central Bank, including details of how and when the non-compliance will be rectified.

In the event of any significant issues concerning asset and liability management appropriate follow-up action is undertaken by the supervisor. Interest-rate risk and market risk are also considered as part of on-site engagements, which are informed by the “Domestic Macroeconomic Environmental Risk Assessment” provided within the Central Bank.

Assessment of GUIDING PRINCIPLE 11: Compliant

Comment: The contemporary economic environment and the range of credit union business models currently employed in Ireland do not give rise to circumstances in which significant interest rate risk generally arises. The evidence is that such risk is minimal at present. In addition, the statutory and regulatory framework, for example the interest rate/investment return-matching provisions of section 31(3) of the 1997 Act, also prescribes an approach which minimizes the potential for the creation of interest rate risk and maximizes the likelihood of its early identification by supervisors.

Irrespective of its level of materiality, should interest rate risk exist in credit unions, supervisors do have appropriate, effective, tools for identifying it, both by analysis of prescribed annual returns and by on-site inspections and examinations if necessary. Additionally, consideration by supervisors of the operation of Guiding Principle 12 (Liquidity and Funding Risk) necessarily identifies many of the key factors likely to create interest rate risk. Appropriate tools are available to supervisors for reducing the likelihood of such risk being created and for mitigating it where it does exist. These are considered in more detail under Guiding Principle 21 (Corrective and Remedial Powers of the Supervisory Authority).

GUIDING PRINCIPLE 12: LIQUIDITY AND FUNDING RISK

Regulated institutions must develop reasonable and prudent liquidity management strategies and contingency plans, including central bank borrowing, standby facilities and/or liquid reserves in a regulated central financial facility, which cover the funding of the institution and the ongoing monitoring of the regulated institution's liquidity/funding position. Supervisory authorities should have the ability to intervene when they believe a regulated institution has an excessively risky funding base or liquidity position. Liquidity risk should be addressed both on a per-institution and on a network-wide basis. Soundly managed network-wide liquidity and stability facilities are highly desirable.

GUIDING PRINCIPLE 12.1. Laws, regulations or the supervisor require credit unions to consistently observe prescribed liquidity requirements including thresholds by reference to which a credit union is subject to supervisory action.

Description and Findings – GUIDING PRINCIPLE 12.1: The Central Bank has prescribed credit union liquidity requirements including the requirement to maintain a liquidity ratio of at least 20% at all times with additional liquidity requirements where credit unions have lending over 5 years in excess of 20% of their loan book. The Central Bank reports that, as of 31 December 2014, all regulated credit unions meet the 20% minimum liquidity ratio requirement.

GUIDING PRINCIPLE 12.2. The supervisor determines that credit unions have a robust liquidity management framework that requires the credit unions to maintain sufficient liquidity to withstand a range of stress events, and includes appropriate policies and processes for managing liquidity risk that have been approved by the credit unions' Boards. The supervisor also determines that these policies and processes provide a comprehensive credit union-wide view of liquidity risk and are consistent with the credit unions' risk profile and systemic importance.

Description and Findings – GUIDING PRINCIPLE 12.2: The Central Bank requires each credit union's board of directors to review, update, and approve both liquidity and asset and liability management policies at least annually. The Central Bank has provided guidance for regulated credit unions that includes a listing of minimum items liquidity management policies and asset and liability management policies should cover, commensurate with the institution's size and complexity, including the overall objectives, cash flow considerations, funding sources, contingency plans, contingent funding sources, and assignment of the overall responsibilities for liquidity management.

GUIDING PRINCIPLE 12.3. The supervisor requires credit unions to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g. credit, market, operational, and reputation risk) may impact the credit union's overall liquidity strategy, and include: (a) an analysis of funding requirements under alternative scenarios; (b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress; (c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits; and (d) regular assessment of the capacity to sell assets.

Description and Findings – GUIDING PRINCIPLE 12.3: Under section 76A of the 1997 Act, credit unions are required to have a strategic plan which must include the funding strategy proposed to support the projected balance sheet structure. Credit unions are also required to have a risk management system to allow them to identify, assess, measure, monitor, report, and manage risks, including liquidity risk.

The minimum liquidity requirements specified by the Central Bank consider liquid assets to be cash and investment having no more than three months to maturity. Credit unions currently hold the majority of their investments in deposits in authorized credit institutions. The majority of credit unions do not hold encumbered assets.

Credit union funding is provided by member savings. Under section 27 of the 1997 Act, no member may have savings that exceed €200,000, or 1% of total assets, whichever is greater, which serves to mitigate concentration risk.

Liquidity levels have risen significantly since 2008 when average sector liquidity stood at 30%. The average liquidity level for credit unions is currently over 47%.

GUIDING PRINCIPLE 12.4. The supervisor determines that credit unions have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the credit union’s contingency funding plan is formally articulated, adequately documented, and sets out the credit union’s strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the credit union’s contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in light of the credit union’s risk profile and systemic importance, the credit union’s contingency funding plan is feasible and requires the credit union to address any deficiencies.

Description and Findings – GUIDING PRINCIPLE 12.4: As noted above, Irish credit unions are funded by member savings, and the average liquidity level in the credit union sector is 47%. The Central Bank has provided guidance on the minimum content of the liquidity management policy in the Liquidity Chapter of the *Credit Union Handbook*. This guidance states the liquidity management policy should cover:

- contingency plans to be put in place if liquidity targets are not met;
- specific actions to be taken to protect the credit union’s liquidity position;
- access to external sources of liquidity, if necessary; and
- notification to the Central Bank where liquidity falls below the regulatory minimum.

Credit unions are also required to have a business continuity plan which should set out internal communication arrangements and escalation plans.

GUIDING PRINCIPLE 12.5. The supervisor determines that credit unions' levels of encumbered balance-sheet assets are managed within acceptable limits to mitigate the risks posed by excessive levels of encumbrance in terms of the impact on the credit union's cost of funding and the implications for the sustainability of their long-term liquidity position. The supervisor requires credit unions to commit to adequate disclosure and to set appropriate limits to mitigate identified risks.

Description and Findings – GUIDING PRINCIPLE 12.5: Credit union assets are largely unencumbered given the nature of the credit union business model, including the use of member savings as the major funding source. Credit unions are required to report encumbrances on assets in each quarterly Prudential Return. Based on information derived from the December 2014 Prudential Return only two credit unions have charges on assets, and in all cases the charges relate to less than 1% of the assets of the respective credit unions.

Given the low level of encumbered assets in the credit union sector, to date, the Central Bank has not established a system-wide process to monitor limits on encumbered assets.

GUIDING PRINCIPLE 12.6. Soundly managed network-wide liquidity and stability facilities are highly desirable.

Description and Findings – GUIDING PRINCIPLE 12.6: While network-wide liquidity and stability facilities are desirable, the Irish credit union sector has not developed such facilities on a large scale basis. The Report of the CCU notes there have been some bilateral liquidity arrangements between Irish credit unions, but only on a very limited scale. The CCU Report also noted that while credit unions are eligible to participate in Eurosystem monetary operations, the expertise, systems, and collateral requirements involved effectively rule out this avenue as a viable option for most credit unions.

The Report of the CCU concluded that “liquidity shortfall is not a pressing matter for most credit unions, and indeed the problem for many now appears to be one of excessive liquidity holdings” and indicated there is no compelling need for a central credit union liquidity mechanism at that time. This situation still pertains.

Assessment of GUIDING PRINCIPLE 12: Compliant.

GUIDING PRINCIPLE 13: INTERNAL CONTROLS

Regulated institutions should have in place an appropriate level of internal controls commensurate with the size and complexity of the institution and its activities. This should include arrangements around delegations of responsibilities, authorizations, segregation of duties, reconciliations and accounting.

GUIDING PRINCIPLE 13.1. Laws, regulations or the supervisor require credit unions to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the credit union’s Board and/or management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address: (a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g. clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g. business origination, payments, reconciliation, risk management, accounting, audit and compliance); (b) accounting policies and processes: reconciliation of accounts, control lists, information for management; (c) checks and balances (or “four eyes principle”): segregation of duties, cross-checking, dual control of assets, double signatures; and (d) safeguarding assets and investments: including physical control and computer access.

Description and Findings - GUIDING PRINCIPLE 13.1: The 1997 Act sets out a requirement for credit unions to have governance arrangements that ensure effective oversight of the activities of the credit union, taking account of the nature, scale and complexity of the business being conducted. The 1997 Act also requires credit unions to have oversight, policies, practices, systems, controls, skills, expertise and reporting arrangements in place to ensure compliance with governance requirements.

These include requirements for:

- a) Governance arrangements which include a clear organizational structure with well defined, transparent and consistent reporting lines which are documented and set out the roles, responsibilities and accountabilities of the officers, including reporting lines for the internal audit function, risk management officer and compliance officer.
- b) Accounting records and systems of control of its business and records and for an annual account of its affairs together with the annual accounts and a copy of the report of the auditor.

- c) Identifying, managing and mitigating operational risks. The board of directors is required to appoint an internal audit function to provide for independent internal oversight and to evaluate and improve the effectiveness of union's internal controls. The board of directors is also required to appoint a compliance officer who is responsible for managing compliance to ensure that the credit union complies with all statutory and regulatory requirements. The 1997 Act also sets out the requirements for required signatories of the credit union.
- d) Having in place information systems and management information policies which should include an information security policy and an information systems asset management policy.

The Central Bank has also issued extensive guidance on internal controls in the Operational Risk section of the *Credit Union Handbook* which addresses all of the areas noted in paragraphs a) to d) above.

Internal controls are assessed on an on-going basis where internal control concerns may arise through 1) review of the external auditor's year end management letter which may include systems and control issues and related governance issues; 2) issues raised in internal/external reports; and 3) timeliness and accuracy of returns.

All credit unions are required to submit an annual compliance statement with Part IV of the 1997 Act to the Central Bank which includes provisions relating to internal controls. Where a credit union identifies material non-compliance with the requirements of Part IV of the 1997 Act, it must submit a Report of Material Non-Compliance to the Central Bank, including details of how and when the non-compliance will be rectified. In the event of any material internal control issues being identified, follow-up action is undertaken as appropriate by the supervisor.

In addition to on-going supervision, internal controls are assessed as part of on-going PRISM on-site engagements as appropriate. These can include meetings with key credit union management personnel, board of directors, BOC members, internal audit function and external auditor as specified in the PRISM engagement model (see Guiding Principle 18 for details of the PRISM engagement model). Risk guidance materials have been developed which set out a number of considerations that supervisors may use when assessing the quality of internal controls and compliance to regulatory requirements.

These considerations are closely aligned with the requirements set out above, and can include reviewing key documentation such as:

- the organizational chart;
- the profile, packs, reports and minutes of the board of directors;
- key policies, including segregation of duties and authorization limits;
- risk management documentation; and
- internal and external reports.

Additional activities are performed as part of AML/CFT risk assessment (See Guiding Principle 14).

Findings in relation to internal controls are communicated to the credit union's board of directors through the issuance of an RMP setting out any deficiencies found, the mitigating action to be taken and the timeframe for implementation of the mitigating action.

During 2015 credit unions' internal control frameworks will be assessed, as appropriate, during credit union engagements that are carried out in line with the Temporary Engagement Model for 2015. This will include engagement with Low Impact credit unions.

GUIDING PRINCIPLE 13.2. The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the credit union's Board) to be an effective check and balance to the business origination units.

Description and Findings - GUIDING PRINCIPLE 13.2: The 1997 Act sets out specific roles and responsibilities relating to risk and internal controls, including the functions of the board of directors, the manager, the risk management officer, the compliance officer and the internal audit function.

The functions of the board of directors include:

- operating a comprehensive decision making process;
- the appointment of a manager, risk management officer and compliance officer;
- the approval of the appointment of any other member of the management team,
- ensuring there is an effective management team in place;
- reviewing the performance of the manager; and
- ensuring that the performance of every other employee and voluntary assistant is reviewed and monitored on an on-going basis.

A new Fitness and Probity regime for credit unions came into effect on August 1, 2013 for credit unions with assets greater than €10 million (August 1, 2015 for all other credit unions). Under this regime, a credit union must not permit a person to perform a CF or PCF unless it is satisfied on reasonable grounds that the person complies with the Standards and has obtained confirmation that the person has agreed to abide by those Standards. Credit unions are responsible for ensuring that staff performing CFs or PCFs meet the Standards, both on appointment to such functions and on an on-going basis. The PCFs are a subset of CFs that also require the pre-approval of the Central Bank prior to appointment.

CFs include the board of directors, manager, risk management officer, compliance officer and internal auditor. The PCF functions requiring Central Bank pre-approval are the chair of the board of directors and the manager.

The Central Bank has issued comprehensive guidance on governance requirements, Fitness and Probity standards and the specific responsibilities and reporting requirements of the risk management officer, compliance officer and internal audit functions based on requirements set out in the 1997 Act.

Credit unions are required to appoint an external auditor under section 113 of the 1997 Act. The Central Bank Act, 1997 places a duty on auditors to make a written report, “Statutory Duty Confirmation,” to the Central Bank and auditors are also required to provide a “management letter” to the Central Bank highlighting areas of significant concern about systems, control and related governance issues in credit unions.

The nomination committee is required to review the composition of the board of directors at least annually for the purpose of identifying any deficiencies in the balance of skills amongst the members of the board of directors and considering other matters relating to deficiencies that may be prescribed by the Central Bank.

On-going supervision and PRISM on-site engagements outlined in Guiding Principle 13.1 are generally applicable to this section with specific consideration of:

- the organization chart;
- the schedule of duration of credit union service, relevant experience and qualifications of all directors, BOC and members of the management team; and
- performance management including training of staff, management and other officers.

Assessment of GUIDING PRINCIPLE 13: Compliant

Comment: Requirements have been introduced for credit unions in relation to managing operational risk and ensuring that they have systems and controls in place. The Central Bank has also issued extensive guidance on internal controls as part of the guidance issued on operational risk. Internal controls are assessed for all credit unions on an on-going basis where internal control concerns may arise through review of the external auditor's year end management letter which may include systems and control issues and related governance issues; issues raised in internal/external reports; annual compliance statement; and timeliness and accuracy of returns. In addition, as part of on-site reviews, meetings may be held with key credit union management personnel and members of the board of directors, committee members, internal audit and external audit.

GUIDING PRINCIPLE 14: ABUSE OF FINANCIAL SERVICES

Regulated institutions should have policies and procedures in place that will prevent them from being used unintentionally for criminal activities, including money laundering. This should include having in place know-your-customer rules. Where the supervisory authority does not have responsibility for regulating such activities, it should ensure it has in place a process of regular liaison or a memorandum of understanding for working with the responsible authority.

GUIDING PRINCIPLE 14.1. Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of credit unions' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.

Description and Findings - GUIDING PRINCIPLE 14.1: The CJA 2010 is the primary legislation for AML/CFT. The CJA 2010 imposes obligations on credit unions to have policies and procedures in place for the detection and prevention of ML/TF. It also sets out the duties, responsibilities and powers of Central Bank including requirements effectively monitor credit unions with regard to their obligations under the CJA 2010, and to take measures that are reasonably necessary to secure their compliance.

The AMLD is a separate division in the Central Bank with specific expertise responsible for the supervision of AML/CFT compliance by credit and financial institutions, including credit unions. The AMLD works closely with supervisors in RCU in assessing compliance with AML/CFT requirements in credit unions and ensuring any required actions are taken where non-compliance is identified.

Under the Central Bank Act 1942, the Central Bank has an obligation to report to the relevant authority any information relevant to that body that leads the Central Bank to suspect that a criminal offence may have been committed by a supervised entity. These also provide for certain prescribed contraventions to be subject to civil enforcement powers of the Central Bank administrative sanctions procedure, which include contraventions of Part 4 of the CJA 2010.

GUIDING PRINCIPLE 14.2. The supervisor determines that credit unions have adequate policies and processes that promote high ethical and professional standards and prevent the credit union from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.

Description and Findings - GUIDING PRINCIPLE 14.2: Under the 1997 Act, all credit unions are required to have a policy on standards of conduct and ethical behaviour for its officers. Additionally, under the Fitness and Probity Standards, any individual performing a CF or PCF within a credit union must be competent and capable, honest, ethical and to act with integrity and be financially sound. These apply to all CFs including the board of directors, manager, risk officer, compliance officer, money laundering reporting officer (MLRO), and the internal audit function.

The key obligations under the CJA 2010 are:

- to identify and verify customers, identify beneficial ownership, and apply enhanced due diligence requirements to higher risk relationships;
- to identify and report of suspicious transactions; and
- to have policies and procedures in place for the prevention and detection ML/TF activities.

All credit unions are required to respond to three questions as part of their Annual Return to their prudential supervisors:

- Does the credit union have policies and procedures in place to prevent and detect money laundering and terrorist financing?

- Have all credit union officers and voluntary assistants been instructed on the law relating to money laundering and terrorist financing and provided with on-going training?
- Name and details of MLRO.

As provided for by the CJA 2010 and the FATF recommendations, the Central Bank has taken a risk based approach to AML/CFT supervision. Credit unions have been classified by PRISM impact rating, with appropriate supervisory tools aligned against each classification as summarized below.

Table 14.2

PRISM Impact Rating	Number of Credit unions	Supervisory Approach
Medium High	22	AML/CFT Risk assessment performed every 2-4 years as part of Prudential Supervisory engagement model. This is supplemented by AML/CFT inspections carried out by AML/CFT supervisors.
Medium Low	244	AML/CFT Risk Assessment performed on a discretionary basis as part of Prudential Supervisory engagement model. This is supplemented by AML/CFT inspections carried out by AML/CFT supervisor.
Low	110	AML/CFT inspections performed on a reactive basis, for example where referrals are received from supervisors.

As part of their on-going AML/CFT Risk Assessment, supervisors determine whether credit unions have established and implemented policies and procedures to achieve compliance with their obligations under the CJA 2010. Risk assessment guidance has been developed to assist supervisors in evaluating the appropriateness of policies and procedures and practices, and compliance to AML/CFT requirements.

An AML/CFT REQ has been developed to support supervisors in AMLD and RCU in evaluating the overall probability that a credit union will experience a material failure with regard to compliance with its obligations under the CJA 2010. The REQ covers a number of AML/CFT areas including questions surrounding governance, approach, training, monitoring and reporting. The REQ is requested as part of the PRISM engagement programme.

The AML/CFT inspections include a review of policies and procedures, sample testing of files, interviews with the MLRO and other relevant personnel. A post inspection letter is issued to the credit union outlining areas of weaknesses requiring remediation and may also result in enforcement action being taken against the credit union. The MLRO is a CF within the credit union and subject to Fitness and Probity Standards which include requirements for competence, conflicts of interest, financial soundness, honesty, ethics and integrity.

GUIDING PRINCIPLE 14.3. *The supervisor determines that credit unions establish Customer Due Diligence (CDD) policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the credit union’s overall risk management and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management programme, on a group-wide basis, has as its essential elements: (a) a customer acceptance policy that identifies business relationships that the credit union will not accept based on identified risks; (b) a customer identification, verification and due diligence programme on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant; (c) policies and processes to monitor and recognise unusual or potentially suspicious transactions; (d) enhanced due diligence on high-risk accounts (e.g. escalation to the credit union’s management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk); (e) enhanced due diligence on politically exposed persons (PEPs) (including, among other things, escalation to the credit union’s management level of decisions on entering into business relationships with these persons); and (f) clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five year retention period.*

Description and Findings - GUIDING PRINCIPLE 14.3: The CJA 2010 sets out an obligation to assess and manage the risks of money laundering or terrorist financing and key CDD. Key obligations include each of the essential elements (a) through (f) above.

As part of their AML/CFT Risk Assessment, supervisors request confirmation from credit unions to demonstrate compliance with their CJA 2010 obligations in relation to the provisions of the CJA 2010. This includes:

- Assessment of AML/CFT risk presented by the credit union’s business model;
- Policies and procedures that reflect a risk based approach to CDD;
- Independent testing of the application of policies and procedures;
- Provision of management information to senior management on AML/CFT issues;
- Testing of outsourcing and third party reliance arrangements; and
- Evidence of on-going monitoring of accounts.

Supervisors may also consider AML/CFT assessments carried out by either the credit union's internal audit function or external consultants and other information including whistle-blowers, or another domestic agency. Under the in-depth inspection program the AML/CFT supervision team in AMLD review the appropriateness and adequacy of the credit union's framework including, the approach to CDD, risk assessment, governance, risk management and control. This is supported by on-site sample testing of key controls.

The Central Bank has advised credit unions that its assessment of AML/CFT compliance to the CJA 2010 will be based on the legislation, but that the Central Bank will have regard to the Core Guidelines and Sectoral Guidance Note for credit unions published by the Department of Finance which sets out a number of considerations and specific requirements regarding the in the application of AML/CFT obligations. These include information on typical risks in credit unions, management responsibilities, internal controls, CDD, reporting, record keeping and training.

The Central Bank has also issued a number of publications surrounding key observations and issues identified through its on-site inspection activities and analysis of REQs. It has also participated in a number of speaking engagements outlining its inspection program, providing feedback on observations, and setting out its expectations of the practical application of the requirements. Key requirements are published on its website including the emphasis of its inspection program and enforcement activities for securing compliance. The Central Bank expects that policies and procedures will be up-to-date and available for inspection, and that management (including boards of directors) can demonstrate full awareness of their responsibilities.

Assessment of GUIDING PRINCIPLE 14: Largely compliant

Comment: Since 2010, the AMLD in the Central Bank has conducted inspections and completed REQs relating to AML/CFT in a number of Medium High and Medium Low Impact credit unions.

The completion of an REQ is a key requirement for evaluating AML/CFT risk probabilities and assessing the nature and extent of further action, including AMLD inspections. While all credit unions are required to answer a number of questions on the Annual Return, the kind of information provided in an REQ may be useful in making a more comprehensive assessment of the compliance regime. An extension of the REQ coverage, with or without the need for on-site inspections, or a more comprehensive compliance questionnaire may help identify a broader range of critical areas where improvements are still required.

Recommendation: The Central Bank may wish to consider requiring all credit unions to submit a more detailed annual questionnaire in order to maintain on-going awareness of AML/CFT requirements. This could help to identify their progress, or required assistance, for implementing effective AML/CFT practices, including the extent of, and plans to satisfy, training requirements. A completion guide, especially for smaller credit unions setting out examples of expectations, may help increase its effectiveness in the development of appropriate on-going processes and practices.

At the present time there are only a limited number of planned AML/CFT inspections for 2015 although the number could increase on a reactive basis as a result of identified material issues. While it is recognized that the Central Bank's approach is risk based, and has excluded Low Impact credit unions, the level of planned engagement does not seem sufficient given the issues noted in the Central Bank's 'Dear CEO' letter published in October 2012. The Central Bank may wish to consider implementing a minimum level of on-site review of key aspects of a credit union's practices.

GUIDING PRINCIPLE 15: OPERATIONAL RISK

Supervisors must be satisfied that credit unions have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the institution and its activities.

GUIDING PRINCIPLE 15.1. Law, regulations or the supervisor require credit unions to have appropriate operational risk management strategies, policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the credit union's strategy, policies and processes are consistent with the credit union's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the credit union on a credit union-wide basis (including periods when operational risk could increase).

Description and Findings - GUIDING PRINCIPLE 15.1: Under the 1997 Act, each credit union is required to identify the operational risks it is exposed to, or is likely to be exposed to. The management and mitigation of operational risk must be fully integrated in a credit union's risk management system. This includes a requirement to manage and mitigate operational risk related to business continuity, records management, information systems, management information, and outsourcing.

The board of directors must review and approve all elements of the risk management system on a regular basis, but at least annually. This includes assessing the appropriateness of the risk management system, taking account of any changes to the strategic plan including the credit union's resources or the external environment, and taking measures necessary to address any deficiencies identified in the risk management system.

The Central Bank has provided comprehensive guidance for credit unions in respect of operational risk in its Operational Risk Chapter of the *Credit Union Handbook*. This includes the identification, assessment, measurement, management and reporting of operational risks. The Central Bank has also indicated that governance arrangements, including arrangements in relation to risk management systems, systems and controls should reflect the nature, scale and complexity of the business being conducted by the credit union.

Supervision

On-going supervision of operational risk strategies, policies and processes are assessed through deficiencies raised in auditors' management letters including systems and controls issues and related governance issues, internal audit reports, internal/external reports including reports from the external auditor, and the timeliness and accuracy of Prudential Returns.

All credit unions are also required to submit an annual compliance statement with Part IV of the 1997 Act to the Central Bank which includes provisions relating to operational risk. Where a credit union identifies material non-compliance with the requirements of Part IV of the 1997 Act, it must submit a Report of Material Non-Compliance to the Central Bank, including details of how and when the non-compliance will be rectified. In the event of any material operational risk issues being identified, follow-up action is undertaken as appropriate by the supervisor.

In addition to on-going supervision, operational risk practices are assessed as part of on-going PRISM on-site engagements. These can include meetings with key credit union management personnel, board of directors, BOC members, internal audit function and external auditor as specified in the PRISM engagement model (see Guiding Principle 18 for details of the PRISM engagement model).

Operational risk guidance materials have been developed which set out a number of considerations that supervisors may use when assessing the quality of operational risk practices and compliance to regulatory requirements. These considerations are closely aligned with the requirements set out above.

Findings in relation to operational risk and the management of operational risk are communicated to the credit union's board of directors through the issuance of an RMP setting out any deficiencies found, the mitigating action to be taken and the timeframe for implementation of the mitigating action.

During 2015 operational risk management processes will be assessed, as appropriate, during credit union engagements that are carried out in line with the Temporary Engagement Model for 2015. This will include engagement with Low Impact credit unions.

GUIDING PRINCIPLE 15.2. The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the credit union's overall risk management process.

Description and Findings - GUIDING PRINCIPLE 15.2: Under the 1997 Act, each credit union is required to identify the operational risks it is exposed to, or is likely to be exposed to. The management and mitigation of operational risk must be fully integrated in a credit union's risk management system. This includes a requirement to manage and mitigate operational risk related to business continuity, records management, information systems, management information, and outsourcing.

Supervision

On-going supervision and PRISM on-site engagements outlined in Guiding Principle 15.1 are generally applicable to this section. As appropriate, this can include an assessment of risk identification and risk registers, management oversight and sign off, policy framework and adherence to policies, oversight of branches (where applicable), staffing resources, outsourcing, cash management, IT and segregation of duties.

GUIDING PRINCIPLE 15.3. The supervisor reviews the quality and comprehensiveness of the credit union's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the credit union. In so doing, the supervisor determines that the credit union is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.

Description and Findings - GUIDING PRINCIPLE 15.3: Under the 1997 Act, credit unions are required to have a business continuity plan in place to ensure that its essential functions can continue during and after the occurrence of one or more abnormal events which could cause a material interruption to the business of the credit union.

The Central Bank has provided comprehensive guidance on the business continuity plan including testing, evaluation of results, follow-up of corrective actions and updating as appropriate. Credit unions should undertake a business impact analysis to consider the likelihood, impact and result of an interruption to the continuity of its operations from abnormal events. This should cover the identification of critical business risks, an assessment of the risk and impact of various interruptions on operations, setting out maximum allowable downtime for critical business activities and acceptable levels of loss, establishing planned recovery levels and timeframes, and identifying key internal and external dependencies. The board of directors should develop recovery strategies which should cover emergency reaction and recovery procedures, communication arrangements including escalation plans, information systems, continuity plans and recovery processes and data back-up and storage strategies, and processes to validate the integrity of the information affected by the interruption.

Supervision

On-going supervision and PRISM on-site engagements outlined in Guiding Principle 15.1 are generally applicable to this criteria. Specifically, supervisors may request a copy of the credit union's disaster recovery and business continuity plan as appropriate. In such cases, supervisors will discuss the disaster recovery and business continuity plan with the credit union and challenge them on areas such as the appropriateness of the plan, roles and responsibilities, the detail of the plan, dependencies on IT providers, and the regular testing of the plan while taking into account the credit union's size and scale. Supervisors will also ensure that the plan has been reviewed in the last year.

GUIDING PRINCIPLE 15.4. The supervisor determines that credit unions have appropriate and effective information systems to: (a) monitor operational risk; (b) compile and analyze operational risk data; and (c) facilitate appropriate reporting mechanisms at the credit unions' Boards, management and business line levels that support proactive management of operational risk.

Description and Findings - GUIDING PRINCIPLE 15.4: Under the 1997 Act credit unions are required to develop, prepare, implement and maintain secure and reliable information systems to enable the board of directors and those involved in the management of the credit union to control, direct and manage its affairs. The Central Bank has provided guidance on credit union

information systems in the Operational Risk Chapter of the *Credit Union Handbook*. The operational risks identified by a credit union's risk management system should be included in the credit union's risk register and be assessed, measured and monitored in accordance with the credit union's overall risk management process. Where a significant operational risk event occurs, the risk management officer should bring this to the attention of the board of directors (or risk committee where one exists) immediately.

The Central Bank completed two IT surveys in credit unions in 2013 and 2014. Analysis of the first survey in 2013 to all credit unions, which was issued to all credit unions, indicated that IT governance and controls across the credit union sector needed to be improved. The Central Bank issued a communication reminding credit unions that responsibility for adequacy of IT systems and controls remains with the board of directors of the credit union. This included developing a clear IT strategy, aligned to and ideally part of their business strategy, to ensure that their IT systems, governance and controls are commensurate with the business direction of the credit union, and for the board of directors to ensure they have access to quality information to support their decision making and analysis.

Analysis of the second survey in 2014, which applied to Medium High Impact and Medium Low Impact credit unions, indicated a disappointing level of progress made by many credit unions, in their own self-assessment, in managing and controlling the risks associated with IT. Following the 2014 survey the Central Bank issued a further communication to all credit unions indicating that they should:

- carry out a full self-assessment of their own IT systems and related governance and controls;
- document any risks and associated remediation actions in respect of non-compliant IT assessment areas in the credit union's risk register; and
- present this information to the board of directors as soon as possible.

The communication also reminded credit unions that the internal audit function should provide the board of directors with additional clarity and support regarding the quality of policies, systems and controls and indicated that as part of future on-site engagement with credit unions the Central Bank may seek to evidence the treatment of IT risk in the credit union's risk register, and also to evidence progress and improvements made.

Supervision

On-going supervision and PRISM on-site engagements outlined in Guiding Principle 15.1 are generally applicable to this section. Specifically, in certain credit unions the supervisor will

review a credit union's latest IT survey response and may request and review the following documentation: IT strategic plan, supplier contracts, IT Service level agreements, IT risk register, IT security policy, IT change policy, IT asset register and business continuity plan.

During on-site engagements, the supervision team will discuss IT Governance and controls (including quality of implementation) with certain credit unions. Policies may also be reviewed as necessary. During 2015 information systems will be assessed in certain credit unions during engagements that are carried out in line with the Temporary Engagement Model for 2015.

Assessment of GUIDING PRINCIPLE 15: Compliant

Comment: Credit unions are required to identify the operational risks that they are exposed to, or likely to be exposed to, and provide for the management and mitigation of those risks in their risk management system. Requirements also exist in specific areas of operational risk including information systems, management information, business continuity and outsourcing. In relation to information systems, it is evident that IT issues are a significant and continuing risk area in the credit union sector. Responses to recent surveys suggest that limited progress is being made to resolve identified issues in a timely manner. The modification to the supervisory engagement model in 2015 will focus on on-site IT assessments in certain credit unions which will likely elevate the awareness of outstanding weaknesses.

Recommendation: The Central Bank may wish to concentrate its further review of IT Risks on those credit unions with more complex products and services, or that seek to expand existing services, and where material higher risk issues exist in this space.

GUIDING PRINCIPLE 16: INTERNAL AUDIT

The supervisory authority should consider the need for an appropriately qualified, independent, and adequately resourced internal audit function. The internal audit function should focus on ensuring that the internal control function operates effectively. Where there is an internal audit function, it should report to an appropriate level within the regulated institution and must have direct access to the board where it considers this necessary. The scope of internal auditing within an organization may involve topics such as the efficacy of operations, the reliability of financial reporting, deterring and investigating fraud, safeguarding assets, and compliance with laws and regulations.

GUIDING PRINCIPLE 16.1. The supervisor determines that credit unions have an independent, permanent, and effective internal audit function charged with: (a) assessing whether existing

policies, processes, and internal controls (including risk management, compliance, and governance processes) are effective, appropriate, and remain sufficient for the credit union's business; and (b) ensuring that policies and processes are complied with.

Description and Findings – GUIDING PRINCIPLE 16.1: Section 76K of the 1997 Act requires the board of directors of each credit union to appoint an internal audit function and establishes the independence, duties, responsibilities, and reporting requirements. The board of directors is required to regularly review (at least annually) and approve the internal audit charter and the internal audit plan.

All credit unions are required to provide information on the internal audit function as part of their annual Year End Return filed with the Central Bank. Since 3 March 2014, credit unions have been required to submit an annual compliance statement confirming compliance with Part IV of the 1997 Act, which includes the Section 76K internal audit requirements. Credit unions reporting material noncompliance with requirements in Part IV of the 1997 Act must submit a Report of Material Non-Compliance, including details on how and when the non-compliance will be corrected.

Central Bank supervisors review the quality of the internal audit function as part of the ongoing supervision process. Under the PRISM system and methodology, a review of internal audit function is included as part of the governance risk assessment for Medium High Impact credit unions.

During onsite engagements Central Bank supervisors meet with internal auditors to assess the independence, reporting, and overall effectiveness of the internal audit function.

GUIDING PRINCIPLE 16.2. The supervisor determines that the internal audit function: (a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; (b) has appropriate independence with reporting lines to the credit union's Board or to an audit committee of the Board, and has status within the credit union to ensure that management reacts to and acts upon its recommendations; (c) is kept informed in a timely manner of any material changes made to the credit union's risk management strategy, policies, or processes; (d) has full access to and communication with any member of staff as well as full access to records, files, or data of the credit union and its affiliates, whenever relevant to the performance of its duties; (e) employs a methodology that identifies the material risks run by the credit union; (f) prepares an audit

plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and (g) has the authority to assess any outsourced functions.

Description and Findings – GUIDING PRINCIPLE 16.2: The Central Bank regulatory framework includes specific requirements covering items (a) through (g) in Guiding Principle 16.2.

- (a) Resources and staff: The Central Bank has indicated in guidance that the internal audit function should have adequate time and resources to carry out its functions having regard to the nature, scale, complexity and risk profile of the credit union.
- (b) Independence and reporting lines: Section 76K(4) of the 1997 Act requires that the internal audit function be “separate from other functions and activities of the credit union and be capable of operating independently of management and without undue influence over its activities.” In addition, Central Bank guidance states that the internal audit function should be appointed at a senior level to facilitate the appropriate standing and authority within the credit union, be separate from other functions and avoid conflicts of interest. Under section 76K(5) of the 1997 Act the internal audit function must report the results of its evaluations and recommendations to the board of directors (or audit committee, where one exists) on a regular basis, and at least quarterly.
- (c) Kept informed in a timely manner: Section 55(8) of the 1997 Act requires the board of directors to regularly review and approve any updates to the internal audit charter and plan.
- (d) Access to communications and records: Section 76K(7) of the 1997 Act states that the internal audit function is to be provided with access at all times to the books and documents (including draft documents) of the credit union to enable it to carry out its functions.
- (e) Employs a methodology that identifies the material risks: Guidance indicates that in advance of preparing the audit plan, the internal audit function should undertake a risk assessment to identify key risks within the credit union. Activities that are determined to be higher risk should be audited in more depth and more frequently than activities that are determined to be lower risk.
- (f) Audit Plan: The internal audit function is required to prepare an internal audit plan detailing the scope and objectives of audits, setting priorities in relation to areas to be audited and determining the resources required to implement the plan. Under section 76K(3) of the

1997 Act, the internal audit plan must be approved by the board of directors of a credit union.

- (g) Authority to assess any outsourced functions: Guidance indicates that where an activity is outsourced, the scope of the internal audit function must be updated to take account of the outsourced activities.

In addition to the ongoing supervision processes noted in Guiding Principle 16.1, during on-site PRISM engagements, as part of an assessment of governance risk in Medium High Impact credit unions, supervisors assess the level of resourcing, training, and overall competence of the internal audit function. Supervisors also review the internal audit plan, priorities, and reporting processes to assess the overall quality of the internal audit function.

Assessment of GUIDING PRINCIPLE 16: Compliant

GUIDING PRINCIPLE 17: SUPERVISORY ACCESS

Credit unions should grant the supervisory authority complete and unfettered access to all aspects it considers necessary. The supervisory authority must have the ability to enforce access where this is not provided.

GUIDING PRINCIPLE 17.1. The supervisor has the power to request and receive any relevant information from credit unions, irrespective of their activities, where the supervisor believes that it is material to the condition of the credit union, or to the assessment of the risks of the credit union or is needed to support resolution planning. This includes internal management information.

Description and Findings – GUIDING PRINCIPLE 17.1: Section 91 of the 1997 Act provides that the Central Bank may compel, copy, and solicit explanations regarding any books, documents, or information from a credit union, its officers, members, agents, or liquidators, and any other persons who have books, records, and information “reasonably required” by the Central Bank in carrying out its powers under the 1997 Act.

Part 3 of the Central Bank (Supervision and Enforcement) Act 2013 also provides comprehensive powers to the Central Bank to compel information to be provided to it, including requiring a credit union to provide forecasts, plans, accounts, or other documents, as specified by the Central Bank.

Part 3 of the Central Bank Reform Act of 2010 empowers the Central Bank to request documentation from and to interview an individual as part of the Central Bank's consideration of the individual's fitness and probity to serve as a designated credit union officer.

The Central Bank has the power to appoint authorized officers under Part 3 of the Central Bank (Supervision and Enforcement) Act 2013. They have a number of powers to access records. An authorized officer may be an officer or an employee of the Central Bank or another suitably qualified person who has been appointed by warrant

Part 2 of the Central Bank (Supervision and Enforcement) Act of 2013 empowers the Central Bank to procure a third party report investigating the conduct and affairs of a credit union, with the cost of such report paid by the credit union. This "skilled persons report" must be prepared by a person recognized by the Central Bank as having the necessary skills to do so, and the credit union must assist the third party in preparing their report.

Under the Central Bank and Credit Institutions (Resolution) Act 2011, the Central Bank has the following powers:

- Directed transfers: The Central Bank is empowered to require a credit union to provide information to the Central Bank where a transfer order is proposed. Under this power, any information relating to the assets and liabilities of a credit union can be requested where it is required to "permit the effective and efficient making of a proposed transfer order."
- Resolutions: The Central Bank is empowered to direct a credit union to provide such information and analysis as the Central Bank requires for the preparation of a resolution plan.

GUIDING PRINCIPLE 17.2. The supervisor has the power to access all credit union records for the furtherance of supervisory work. The supervisor also has similar access to the credit union's Board, management, and staff, when required.

Description and Findings – GUIDING PRINCIPLE 17.2: As noted above, the Central Bank has access to any information, books, or records relating to a credit union reasonably required in the exercise of its powers. The Central Bank (Supervision and Enforcement) Act of 2013 also empowers Central Bank officers to require a person to answer questions or explain and provide rationale for business decisions. Section 91(4) of the 1997 Act also empowers the Central Bank to require an officer, member, agent, or liquidator of a credit union to provide an explanation of any books, documents, or information reasonably required by the Central Bank.

GUIDING PRINCIPLE 17.3. The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines the appropriate level of the credit union's management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.

Description and Findings – GUIDING PRINCIPLE 17.3: An enforcement action can be taken by the Central Bank through the administrative sanctions procedure where a credit union breaches any requirement in relation to the provision of information imposed by the Central Bank, or under legislation (see Guiding Principle 21 for further detail).

The annual audited accounts must be signed by the manager of the credit union, a member of the board of directors, and a member of the BOC. In addition, prior to submitting returns a credit union must confirm that the information on the Prudential Return accurately reflects the financial position of the credit union and has been verified and approved by the manager, and that the information on the Year End Return is in accordance with the annual audited accounts and has been approved and signed off by the credit union board of directors.

Where RCU has concerns about the integrity and validity of the information submitted, in the first instance the supervisor follows up with the credit union to verify the accuracy of the information submitted. Where significant inconsistencies are identified supervisors follow up with credit unions as appropriate to ensure that these are adequately explained.

Where an entity fails to provide the required information or provides inaccurate or misleading information to the Central Bank, this is a prescribed contravention and may be subject to the powers of sanction under provisions of the Central Bank Act, 1942. Further details on sanctions, including the administrative sanctions procedure, are found in Guiding Principle 21.

Assessment of GUIDING PRINCIPLE 17: Compliant.

GUIDING PRINCIPLE 18: SUPERVISORY APPROACH, TECHNIQUES, AND RESOURCES

The supervisory authority should develop and maintain a thorough understanding of the operations of individual regulated institutions and should deploy an effective and ongoing combination of offsite and onsite supervisory techniques. The supervisory authority should

have appropriately qualified and independent staff and be adequately resourced to implement its supervisory approach.

GUIDING PRINCIPLE 18.1. *The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact, and scope of the risks: (a) which credit unions are exposed to; and (b) which credit unions present to the safety and soundness of the credit union sector. The methodology addresses, among other things, the business focus, risk profile, internal control environment, and the resolvability of credit unions, and permits relevant comparisons between credit unions. The frequency and intensity of supervision of credit unions reflect the outcome of this analysis.*

Description and Findings – GUIDING PRINCIPLE 18.1: The Central Bank's credit union supervisory engagement model program is normally centered on the standard PRISM framework, a risk-based regulatory framework used for all financial services providers regulated by the Central Bank to establish supervisory priorities and allocate resources. The PRISM system uses pre-determined peer groups for comparison, and also allows filtering to create custom peer groups. The PRISM system includes pre-determined peer groups for comparison, and allows filtering to create custom peer groups. The PRISM regulatory approach has been used by RCU in the credit union sector since May 2012. Using the PRISM methodology, the Central Bank has assigned all regulated credit unions to defined impact categories while taking into account the individual institution's risk profile and systemic importance.

The Central Bank currently classifies credit unions as follows, based on a systematic quantitative assessment of the impact of failure. Currently, these impact categories are:

- High Impact – No credit unions are currently classified as High Impact.
- Medium High Impact – 22 credit unions.
- Medium Low Impact – 244 credit unions.
- Low Impact – 110 credit unions.

Under the PRISM system, the minimum frequency and type of supervisory engagements for individual credit unions is determined primarily by the impact category. Medium High Impact credit unions should see FRAs conducted every two to four years. These look at the full spectrum of risks a credit union is likely to face. Approximately 10% of Medium Low Impact credit unions are also subject to proportionate FRA visits each year. There is also a regular program of interaction with the directors and senior management of such credit unions to ensure that supervisors can understand strategic developments and emerging risks at such credit unions. Low Impact credit unions are regulated using a combination of reactive and thematic techniques, supplemented by summary inspections when deemed necessary. Each

FRA requires the development and submission of a comprehensive report to the RGP for review.

Table 18.1

PRISM Credit Union Engagement Activities by Impact Category			
Supervisory Tasks	Medium High	Medium Low	Low
<i>Stress Tests</i>	<i>Possible</i>	<i>No</i>	<i>No</i>
<i>FRA</i>	<i>Yes - once every two to four years</i>	<i>Yes - random/spot basis (10% per year)</i>	<i>No</i>
<i>RGP</i>	<i>Yes - once every two to four years</i>	<i>Post RGP with possibility of batch panels</i>	<i>No</i>
<i>Meeting with management personnel, Chair, External Audit, committees as appropriate</i>	<i>At least annual</i>	<i>Every 18 months</i>	<i>No</i>
<i>Meeting with Internal Auditor /Audit function</i>	<i>Every two years</i>	<i>No</i>	<i>No</i>
<i>Trigger based Supervision</i>	<i>No</i>	<i>Yes</i>	<i>Yes</i>
<i>Triage Team/Enforcement bases approach</i>	<i>No</i>	<i>Partial</i>	<i>Full</i>
<i>Board Meeting Attendance</i>	<i>Possible</i>	<i>very unlikely</i>	<i>No</i>
<i>Regulatory Returns Analysis</i>	<i>Yes</i>	<i>Basic + Automated</i>	<i>Automated</i>
<i>Consumer focused thematic work</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<i>Skilled persons reviews to deal with issues</i>	<i>Possible</i>	<i>Default option</i>	<i>Possible</i>

In 2014 due to RCU resources for PRISM being at only 60% of suggested supervisory resources, RCU targeted to carry out 70% of the minimum PRISM engagements.

2015 Temporary Supervisory Engagement Model

A revised engagement approach for credit unions was developed by RCU in 2015 providing for a temporary change of the PRISM supervisory engagement from being driven by the existing impact basis to a probability risk focus. This revised approach was designed to align supervisory and restructuring goals within current resource constraints by moving to a priority focus on potential consolidators, Low Impact and weaker entities within the sector with a differentiated but more targeted focus.

The 2015 Temporary Supervisory Engagement Model approach consists of on-site engagements with three distinct categories of credit unions and reactive engagement with the balance as set out below:

- 1) credit unions where supervisors have assessed them amongst the strongest across the sector from a viability, governance as well as being of a certain scale and size will have an on-site engagement that focuses primarily on their Strategic orientation, Governance and Risk Management capabilities;
- 2) credit unions categorized as Low Impact under PRISM. This engagement will have a priority focus on viability (strategy/business model) and also assess their governance capabilities with respect to compliance with the legislative and regulatory framework; and
- 3) credit unions deemed by supervisors to be of a high risk where the engagement would focus primarily on risk mitigating actions.

The remaining credit unions who are not part of the above on-site engagements will be subject to reactive supervision incorporating follow up on previously issued RMPs, regulatory returns analysis and KRI alerts and reactive on-site engagement where required.

Supervisory Engagement Methodology for I&R Credit Unions

Credit unions that are in breach of the minimum regulatory reserve requirements and/or have other significant issues of prudential concern (e.g. liquidity issues, valuation of asset issues, credit issues, breaches of other regulatory requirements) are included in the I&R portfolio and are supervised by a specific team. The I&R portfolio can include credit unions from any impact category and the supervisory engagement approach for these credit unions is tailored to reflect the circumstances and particular risks of the individual credit union rather than the impact category, as is the case in the standard PRISM engagement model. The supervisory engagement model for credit unions in the I&R portfolio is aligned to the challenges of those specific credit unions and includes meetings with the board of directors and BOC, asset reviews undertaken by independent consultants, due diligence reviews and meetings in relation to transfers of engagements, securing solvency support and preparatory work for potential resolution actions to be undertaken by the SRU.

GUIDING PRINCIPLE 18.2. The supervisor has processes to understand the risk profile of credit unions and employs a well-defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each credit union is based on the results of this analysis.

Description and Findings – GUIDING PRINCIPLE 18.2: As noted above, the Central Bank has used the PRISM regulatory framework to effectively analyze and understand the risk profile of each regulated credit union.

Central Bank staff has developed a risk-based, forward-looking approach focusing on the following risk categories:

- Credit Risk
- Market Risk
- Operational Risk
- Capital Risk
- Liquidity Risk
- Governance Risk
- Strategy Risk
- Environmental Risk
- Conduct Risk and
- Insurance Risk.

Risk Guidance Materials have been written for each of the risk categories to assist supervisors in making informed judgments in a structured fashion. These materials explain each category, outline key questions for consideration, contain information specific to certain sectors, and provide sample characteristics risk for each category.

Supervisors also monitor, analyze, and receive regular reports on qualitative KRIs derived from the quarterly Prudential Returns and Year End Return filed by each credit union. Where warranted RMPs are issued to credit unions, setting out actions that the credit union is required to take to address supervisory concerns. Supervisors undertake appropriate and timely follow-up to check that credit unions have addressed Central Bank concerns (as set out in RMPs) or implemented requirements communicated to them. Supervisors may also request the internal audit function of credit unions to verify completion of RMP actions.

Since 2012, approximately 3,500 RMP risk issues and remedial actions have been identified and communicated to credit unions to address.

For 2015, a revised engagement approach for credit unions was developed by RCU and agreed with the Central Bank Commission in December 2014 which provides for a temporary change of the PRISM supervisory engagement from being driven by the existing impact basis to a probability risk focus. This revised approach is designed to align supervisory and restructuring goals within current resource constraints by moving to a priority focus on potential

consolidators, Low Impact and weaker entities within the sector with a differentiated but more targeted focus. Under this temporary approach there will be no FRAs or related RGPs during 2015.

GUIDING PRINCIPLE 18.3. The supervisor employs an appropriate mix of on-site and off-site supervision to evaluate the condition of credit unions, their risk profile, internal control environment, and the corrective measures necessary to address supervisory concerns. The specific mix between on-site and off-site supervision may be determined by particular conditions and circumstances of the country and the credit union. The supervisor regularly assesses the quality, effectiveness, and integration of its on-site and off-site functions, and amends its approach, as needed.

Description and Findings – GUIDING PRINCIPLE 18.3: Central Bank supervision teams are responsible for both on-site and off-site supervision of regulated credit unions. During 2014, use of the PRISM engagement model resulted in the following mix of on-site and off-site supervisory activities:

- 17 FRA
- 18 RGP Reviews
- 98 One Day Engagements Focusing on Particular Risk Areas
- 36 Other Related Meetings with Credit Union Officials
- 23 Non-PRISM Engagements of Various Types.

RCU regularly assesses the quality and effectiveness of its on-site and off-site supervision and amends/improves its approach as needed. A significant review and update of the RCU's approach to on-site and off-site supervision was undertaken with the implementation of PRISM in May 2012. More recently, work has been undertaken to amend the PRISM engagement activities for credit unions to reflect changes in the governance structure in credit unions and the new roles and functions in credit unions following the introduction of the new governance requirements in the 1997 Act (see Table 18.1).

In addition, the Central Bank has developed a tailored supervisory approach for credit unions within the I&R portfolio and has developed a Temporary Supervisory Engagement Model for 2015 to align supervisory and restructuring goals within current resource constraints (see Guiding Principle 18.1 for further details).

GUIDING PRINCIPLE 18.4. The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives, and

outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.

Description and Findings – GUIDING PRINCIPLE 18.4: Under the PRISM system planning module, minimum levels of engagement are established dependent on the impact category assigned for each regulated institution. The PRISM guidance materials set out the processes and procedures to be followed in conducting individual credit union reviews. The Supervisory Support Team (SST), a unit within the Risk Governance and Accounting Policy Division, reviews the actual implementation and use of the PRISM process to ensure PRISM engagements are performed on a thorough and consistent basis.

As noted above, RCU supervisory teams are responsible for both on-site and off-site supervision activities, which should serve to facilitate effective communication and information sharing between the two functions.

GUIDING PRINCIPLE 18.5. The supervisor uses a variety of information to regularly review and assess the safety and soundness of credit unions, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, and publicly available information. The supervisor determines that information provided by credit unions is reliable and obtains, as necessary, additional information on the credit unions.

Description and Findings – GUIDING PRINCIPLE 18.5: Information sources used by the Central Bank supervisory staff include the following:

- Scheduled Regulatory Returns – quarterly Prudential Returns submitted by credit unions containing information on reserves, liquidity, large exposures, arrears, provisions, financial performance, and compliance with prudential limits.
- Year-End Returns – annual reports from each credit union including draft and final financial statements and information on the institution’s board of directors, committees, and management.
- Audit Reports – reports from both the Internal and External Auditors, including Statutory Duty Confirmation and Auditor Management Letters. External auditors are also required to submit the relevant management responses to these audit reports.
- Specific Information and Documents Requested from Credit Unions – this information and documentation are generally obtained from credit unions during the FRA process, or as a result of specific engagement meetings.

- PRISM – the PRISM system uses the Central Bank database to generate a variety of alerts designed to assist credit union supervisors in regularly reviewing and assessing the safety and soundness of regulated institutions. These alerts, generally triggered by significant changes in individual institution impact metrics, or KRIs, or alerts in relation to risk mitigation actions required, or pending engagement tasks, act as an early warning system. PRISM alerts are only closed once the issues underlying the alert have been addressed and the rationale for closing the alert is recorded in the PRISM system.
- Annual Compliance Statement- since March 2014, all credit unions are required to submit an annual compliance statement to the Central Bank no later than November 30 of each year. The annual compliance statement requires each institution's management to certify how they are complying with the legal and regulatory requirements in Part IV of the 1997 Act, the provisions of which relate to the management of the credit union.

Procedures to determine the reliability of information provided by credit unions include analytical review of KRI alerts, detailed year-end review of information submitted in credit union Year-End Returns, and requesting internal auditors and external third parties to conduct independent reviews of information reliability, where issues arise.

GUIDING PRINCIPLE 18.6. The supervisory authority should have appropriately qualified and independent staff and be adequately resourced to implement its supervisory approach.

Description and Findings – GUIDING PRINCIPLE 18.6: The Central Bank appears to have a well-defined process to ensure that all staff meets the required qualifications for their respective job categories prior to appointment. Job vacancies are advertised both internally and externally, as appropriate.

The Central Bank has a significant training budget which provides both approved technical training opportunities and support for external academic and professional education. RCU has its own training budget which is used for specific supervisory training needs identified during the Training Needs Analysis process. All staff members are required to develop, with input from line managers, a personal learning and development plan as part of the annual performance management process.

RCU is currently staffed at only 60% of the PRISM suggested supervisory resources based upon the number and impact categories of regulated credit unions. Under PRISM engagement guidance, estimated resourcing requirements have been provided for each impact category.

Table 18.6

Impact Category	Supervisors Allocated to Credit Union
Medium High Impact	Between 50% and 100% of a supervisor
Medium Low Impact	Between 10% and 20% of a supervisor
Low Impact	Reactive supervision

The guidance also sets out an approach for the allocation of time for key activities in relation to PRISM engagements such as for an FRA - 25% preparation, 25% on-site and 50% write up, review, judgment and update of PRISM and any RMP actions arising.

As part of its regular manpower planning process RCU submitted a request for additional resources in the third quarter of 2014 based on the current and potential future commitments for PRISM engagements and other credit union regulatory requirements. A decision on allocating additional resources was postponed until later in 2015. As a result of the postponement in 2014 of the decision on additional resources, the 2015 Temporary Supervisory Engagement Model was developed and approved for use in credit union regulation during 2015. Any decision on allocating allocation of resources in 2015 will be based on a longer term engagement approach and will reflect the experience from the 2015 Temporary Supervisory Engagement Model and the emerging shape of a restructured credit union sector.

In addition to ongoing supervision through PRISM engagements, RCU has allocated resources to the areas of restructuring (dedicated I&R team of 12 staff as of 31 March 2015) and policy development. This number includes 2 secondees that do not form part of RCU's staff complement. The allocation reflects the particular stage of maturity of the Irish credit union sector, including the significant level of regulatory change, the restructuring of the credit union sector, and the challenging operating environment for credit unions. The ongoing manpower planning within the Central Bank seeks to ensure that an adequate level of resources is allocated to RCU that is appropriate for all the activities to be undertaken by RCU, PRISM engagements, restructuring, and policy development and implementation, in order to deliver on its regulatory strategy.

Assessment of GUIDING PRINCIPLE 18: Largely Compliant.

Comment: The Central Bank's regulatory framework is comprehensive and provides a systematic, risk-based, and well-defined regulatory approach under the PRISM engagement model. PRISM however was designed primarily for financial institutions that have a more complex business and operating model that encompasses a wide array of risks including complex lending and deposit products. Credit unions in Ireland at this time have a very basic business model. Although modified for the credit union sector, PRISM is heavily reliant on data and information, especially for developing a report following a Full Risk Assessment (FRA) for discussion and challenge by a Risk Governance Panel (RGP). However, other elements of PRISM that do not include an FRA and supporting RGP review are not as resource dependent. These include regular on-site meetings with senior management, board and committee members.

The current level of resources allocated to the RCU supervisory engagement model is approximately 60% of the level of suggested supervisory resources. This is acknowledged in the Central Bank as a matter for longer term review. Some refinements introduced with implementation of the 2015 Temporary Supervisory Engagement Model have somewhat mitigated the effect of this resource deficit, and appear to be a very appropriate strategy given the relatively simple business model and overall size of Irish credit unions, and the restructuring occurring within the credit union sector. Under this approach all credit unions will be considered for a modified engagement although no FRAs or related RGPs will be undertaken for a temporary period.

Recommendation: PRISM, the Central Bank's risk based supervisory framework, has been applied to credit unions since 2012. In view of the need for and value of on-site engagement and given that the Central Bank resources allocated to supervisory engagement under PRISM is approximately 60% of the level of PRISM suggested supervisory resources, we recommend that the RCU should consider the way in which its PRISM framework is most effectively employed by RCU. RCU needs to ensure that it has the adequate level of resources necessary to deliver on all aspects of its regulatory strategy.

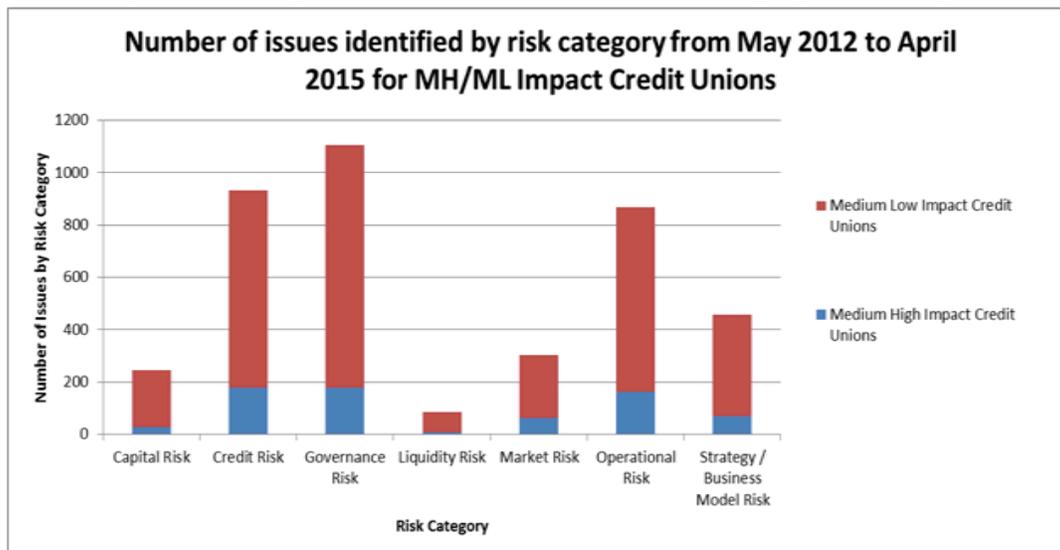
Although modified for the credit union sector, PRISM is heavily reliant on off-site risk assessment, analysis and review. Refinements introduced with implementation of the 2015 Temporary Supervisory Engagement Model have somewhat mitigated the effect of the resource shortfall. These refinements include engagement with Low Impact credit unions and actually appear to be a very appropriate strategy for 2015 given the low level of complexity of the business model, overall size of Irish credit unions and the current context of the Irish credit union sector, including the embedding of the new regulatory framework and the restructuring of the credit union sector currently underway.

The Central Bank may also wish to consider embedding some or all of these 2015 refinements into the longer-term supervisory engagement model on an on-going basis. This could include more streamlined off-site processes, scaled back documentation, reporting and review requirements commensurate with the scale and complexity of the credit union, and more regular on-site engagements with appropriate minimum levels of testing and sampling in critical key risk areas in all credit unions.

In order to assist credit unions in their understanding of the process, the Central Bank may wish to consider publishing an overview of its approach for on-site engagements including key considerations that supervisors use when assessing the adequacy of risk management and governance practices, strategic planning and viability and for determining material weaknesses.

Since 2012, approximately 3,500 risk issues have been identified and communicated to credit unions along with the RMP actions required to be taken by the credit union to address. Where possible, RMPs should concentrate on material risk issues that need to be addressed as a matter of urgency while recording other outstanding weaknesses that will need to be addressed over time. For example, RMPs for material risk issues would have specific actions and timelines set out by the supervisor. Other less critical deficiencies could be individually listed for credit unions to acknowledge, develop and approve appropriate action plans and timelines for supervisory follow up as part of an on-site review engagement.

**Table 18 - PRISM Issues Identified by Risk Category
(An issue may relate to more than one risk category in PRISM)**



GUIDING PRINCIPLE 19: SUPERVISORY REPORTING

The supervisory authority should have the ability to collect, review, and analyze financial and/or statistical reports from regulated institutions in whatever form it requires. It should also have the ability to have such reports or forms independently verified where it considers this necessary.

GUIDING PRINCIPLE 19.1. The supervisor has the power to require credit unions to submit information on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography, and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.

Description and Findings – GUIDING PRINCIPLE 19.1: The 1997 Act and the Central Bank (Supervision and Enforcement) Act 2013 empower the Central Bank to require regulated credit unions, and any person that has information on a credit union, to submit information to the Central Bank as required in the performance of its functions. The Central Bank can prescribe requirements for the format, content, and frequency of submission of required information, and can require institutions to engage external experts, for a variety of tasks, including the verification of supervisory information, where deemed necessary.

The regular reports the Central Bank requires credit unions to provide, as discussed above under Guiding Principle 18.5, are comprehensive and provide sufficient information to meet the requirements of Guiding Principle 19.1. The Central Bank may also require specific reports, including reports prepared and verified by independent experts, on any matters required in the performance of its duties.

GUIDING PRINCIPLE 19.2. The supervisor collects and analyses information from credit unions at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the credit union.

Description and Findings – GUIDING PRINCIPLE 19.2: The Central Bank requires all credit unions to file quarterly Prudential Returns and Year End Returns, including audited accounts, are collected from all credit unions annually. Credit unions may be required to submit additional reports based on their risk profile and impact categorization.

GUIDING PRINCIPLE 19.3. The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a programme for the periodic verification of supervisory returns by means either of the supervisor’s own staff or of external experts.

Description and Findings – GUIDING PRINCIPLE 19.3: Credit unions submit supervisory information through an electronic online reporting system that incorporates various validation procedures to ensure validity and internal consistency of the information being submitted. If the Central Bank has concerns regarding the validity and integrity of information submitted by the credit union, supervisors follow up with the credit union to verify the accuracy of the information submitted and, where necessary, require the credit union to amend and resubmit the information.

During on-site supervision at credit unions, specific supervision procedures, such as bank and other account reconciliations, may be used to validate information submitted on the Prudential Returns. Where there are significant concerns regarding the true financial position of a credit union an asset review may be undertaken by a third party appointed by the Central Bank or credit union, as appropriate. One of the significant purposes of these third party asset reviews is to determine the validity and integrity of supervisory information.

Assessment of GUIDING PRINCIPLE 19: Compliant.

GUIDING PRINCIPLE 20: ACCOUNTING AND DISCLOSURE

Regulated institutions should maintain adequate records that have been prepared in accordance with the relevant accounting laws in its jurisdiction.

GUIDING PRINCIPLE 20.1. The supervisor holds the credit union’s Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.

Description and Findings – GUIDING PRINCIPLE 20.1: Legislation and binding standards set out comprehensive requirements for credit unions to maintain adequate and reliable records, prepare financial statements in accordance with widely accepted accounting principles and to have an independent external auditor’s opinion.

The accounting records kept must contain entries from day to day of all sums of money received and expended by the credit union and the matters in respect of which the receipt and expenditure take place; a record of the assets and liabilities of the credit union and entries from day to day of every transaction entered into by the credit union which will or may give rise to liabilities or assets of the credit union; and in respect of the provision of services, a record of the services provided and all transactions relating to them.

The 1997 Act requires a credit union to:

- a) maintain proper accounting records (section 108);
- b) establish and maintain systems of control and safe custody (section 109);
- c) adhere to certain accounting principles (section 110);
- d) prepare annual accounts which provide a 'true and fair view' of its income and expenditure for the year end of the state of its affairs at year-end, signed by certain officers of the credit union and containing an external auditor's report (section 111).

RCU issues a communication to credit unions annually setting out key areas for the board of directors of credit unions to focus on when considering their approach to the financial year-end.

The requirement for annual accounts to give a true and fair view is regarded as requiring compliance with relevant accounting standards as well as compliance with legislative requirements in the 1997 Act. Irish credit unions prepare their annual accounts in accordance with the 1997 Act and with local GAAP comprising FRSs issued by the FRC in the UK and promulgated in Ireland by Chartered Accountants Ireland. Where necessary, for example where the external auditor has identified significant issues in its Management Letter, the supervisor will meet the auditor and if an issue potentially requiring attention is confirmed an RMP may be issued.

The obligation to comply with the provisions regarding true and fair accounts is underpinned by a criminal offence applicable to members of a credit union's board of directors; section 111(5) of the 1997 Act.

GUIDING PRINCIPLE 20.2. The supervisor determines that credit unions use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that credit unions document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.

Description and Findings – GUIDING PRINCIPLE 20.2: Section 110 of the 1997 Act sets out the accounting principles to be adhered to in the preparation of the accounts of a credit union.

Section 111 of the 1997 Act prescribes the content of the annual accounts of a credit union and requires that credit unions must not publish its income and expenditure, balance sheet or statement unless it has been audited, incorporates a report by the auditor stating whether it complies with the requirement to give a true and fair view and has been signed by the manager, a member of the board of directors and a member of the BOC.

Under section 124 of the 1997 Act, credit unions are required, not later than 31 March in each year, to send to the Central Bank a return relating to its affairs for the most recent financial year (1 October – 30 September) along with a copy of its annual accounts and a copy of the report of the auditor on the credit union’s annual accounts for that financial year. The auditor’s report states that the audit was conducted in accordance with International Standards on Auditing (UK and Ireland) issued by the FRC. Section 120(3) of the 1997 Act sets out matters which must be addressed in the auditor’s report, including his opinion on whether proper accounting records have been kept by the credit union and whether the annual accounts have been properly prepared so as to comply with any requirements made by, or under, the 1997 Act and give a true and fair view in accordance with local GAAP.

The Central Bank’s Guidance Note for Credit Unions on Matters Relating to Accounting for Investments and Distribution Policy (April 2009) sets out guidance on the valuation of investments. The Central Bank has indicated in this guidance that in most cases the lower of cost and NRV will be the most appropriate valuation method for investments. The use of this method should assist in ensuring that credit unions identify and monitor problem assets on an on-going basis. The external auditor also reviews the investment valuations held at year-end during their year-end audit. Credit unions are required to have investment policies that are reviewed, updated and approved by the board of directors at least annually. The Central Bank has issued guidance, contained in the Investments Chapter of the *Credit Union Handbook*, on what investment policies should cover, including the process for monitoring the value of investments and the accounting treatment adopted for the valuation of investments.

The Central Bank, during on-site and off-site reviews, assesses whether the valuations used for regulatory purposes are reliable and prudent. Where the Central Bank determines that valuations are not sufficiently prudent it requires the credit union to consider and make adjustments as appropriate. Supervisors assess the information reported in draft financial statements for compliance with key financial regulatory requirements and for reflection of asset review findings (where relevant). Where significant inconsistencies between information reported in Year End Returns and key figures reported in the year-end Prudential Return (30 September) are identified, supervisors follow up with credit unions as appropriate to ensure that these are adequately explained. Supervisors focus in particular on the reporting of reserves, bad debt provisions and the valuation of assets in annual accounts. Should any issues of concern arise a supervisor will revert to the credit union and/ or its auditors and where a supervisor has significant concerns about the information in a credit union's draft financial statements then, for example, the credit union may be notified that it should not proceed with setting a date for its AGM until supervisory concerns are addressed.

The supervisor also determines that credit unions are using valuation practices consistent with accounting standards widely accepted internationally. The supervisor determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that credit unions document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes. Where necessary, during off-site engagements the supervisor will meet the external auditor and if an issue potentially requiring attention is confirmed an RMP may be issued.

RCU also issues a communication to auditors annually on the auditing of the annual accounts of credit unions which highlights key regulatory matters for auditors to be aware of during their audit. In addition, RCU makes presentations to auditors to provide them with updates on changes to the regulatory framework for credit unions.

RCU engages a number of external consultants to carry out independent verification and validation of the true financial position of a number of credit unions. These reviews assess the need for impairments on the loan portfolio, investment portfolio and the fixed assets held by the credit union. Following a process, which allows comment from the credit union concerned, the finalized report will contain an RMP, should one be required to address impairments clearly identified by the report. The credit union will be expected to execute the RMP and reflect all impairments in the financial statements of the accounts.

Assessment of GUIDING PRINCIPLE 20: Compliant

Comment: Accounting standards and practices are under constant review by the professional and standards bodies and the Central Bank works closely with those bodies in connection with the formulation of appropriate provisions for Irish credit unions. It also issues additional guidance, such as that provided in separate annual circulars to credit unions and to their external auditors, which are a valuable tool in drawing attention to credit union-specific accounting issues and to any current topics of particular relevance and concern. The Central Bank has also engaged directly with auditors in presentations to provide updates on changes to the regulatory framework for credit unions. It is evident that the Central Bank regards this area as being crucially important to the stability and reputation of the sector as a whole, in light of the historical impact of unrealistic asset valuations by some credit unions in their accounts and a question as to the extent of consideration by auditors.

There are examples and evidence, particularly associated with work done in connection with the Asset Review program, that illustrate the outcomes that the Central Bank has achieved in challenging defective practices and this focus will be maintained in its ongoing work in that area. During 2014 a number of credit unions were contacted in relation to fixed asset valuations in year-end accounts and adherence to FRS11 (Impairment of Assets and Goodwill). Where a concern existed, credit unions were asked to carry out a value in use exercise to ascertain if the value of the premises required impairment. Supervisors reviewed the value in use exercises submitted to examine the robustness of projections and to assess whether the projections were reasonable and supportable. In certain instances this led to impairments being identified. Where an impairment was identified and agreed it was reflected in the financial statements of the credit union. If the impairment was contested then a third party could be engaged to carry out an independent review of the fixed asset valuation. Additional regulatory actions followed, where appropriate, dependent on the impact of an impairment on the financial position of the credit union.

A typical example is that of a review by an external consultant to carry out independent verification and validation of the true financial position of a credit union which, among other things, was then required to increase its provision for bad and doubtful debts by approximately €300k. This RMP was accepted and subsequently implemented by the credit union.

The laws and regulations that apply directly to credit unions are complemented by a number of important statutory provisions regarding the responsibilities of auditors and the standards expected of them. In general, accounting requirements for credit unions are comprehensive and auditors are firmly aware of and have regard to the financial, operating and regulatory environment for credit unions when carrying out their work.

If necessary, however, the Central Bank has the power to remove the auditor of a credit union where it considers it necessary in the interest of members or of the “orderly and proper” regulation of the credit union. The Central Bank also has the power to veto the appointment or re-appointment of an auditor of a credit union or the filling of a casual vacancy of auditor. For example, in a particular case, having identified potential issues in relation to the independence and specific skill sets and expertise of a credit union’s auditor, RCU required the credit union to appoint a new auditor.

The draft regulations on systems, controls and reporting arrangements in CP88 propose certain disclosure requirements for credit union annual accounts. These include a requirement to disclose information on the credit union’s reserves, the performance of the loan book, loans outstanding to related parties and accounting policies in relation to investments.

Recommendation: The Central Bank has undertaken important supervisory work in establishing the true state of credit union loan books, through asset reviews and PRISM on-site engagements in selected credit unions, and in laying the foundations for higher-quality, disciplined, lending. It also provides useful, practical, guidance to credit unions and audit firms regarding the correct approaches to be taken to provisioning and the prudent management of non-performing or impaired loans. In view of the key importance of the latter issue, we recommend that the Central Bank maintains and, if possible, increases its focus on providing guidance and education to the sector in these areas.

GUIDING PRINCIPLE 21: CORRECTIVE AND REMEDIAL POWERS OF THE SUPERVISORY AUTHORITY

An adequate range of enforcement tools to facilitate timely corrective action should be at the supervisory authority's disposal. This includes the ability to issue appropriate legal orders, to revoke licenses or to recommend revocation. This also includes the ability to impose restrictions on the activities and operations that institutions conduct.

GUIDING PRINCIPLE 21.1. The supervisor has available an appropriate range of supervisory tools for use when, in the supervisor’s judgment, a credit union is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the credit union or credit union sector, or when the interests of depositors are otherwise threatened.

Description and Findings GUIDING PRINCIPLE 21.1: The Central Bank benefits from a very wide range of enforcement tools available to it to facilitate timely action when, in its judgment, a credit union is not complying with laws, regulations or required actions, as follows:

- ability to request credit unions to implement RMPs with agreement on timeframes for completion of activities;
- power to give Regulatory Directions, including directions to restrict a credit union's activities and operations;
- power to sanction credit unions under its administrative sanctions procedure and to publicise the findings and sanctions imposed;
- power to impose conditions on the registration of a credit union;
- power to appoint and/or remove a person as a director of a credit union;
- power to prohibit an individual from taking up certain roles (PCFs) in a credit union and power to prohibit individuals from continuing to act in "controlled functions" where there are concerns as to the "fitness and probity" of the individual;
- power in relation to the remediation and resolution of credit unions under the Central Bank and Credit Institutions (Resolution) Act, 2011, specifically in relation to transfer orders, the appointment of a special manager, the establishment of a bridge bank, the requirement for a recovery plan/resolution plan, and the liquidation of credit unions;
- power to petition the High Court for an order to appoint an Administrator or an Examiner of a failing credit union;
- power to petition the High Court for an order to wind up a credit union in certain circumstances;
- power to suspend/revoke the registration of a credit union in certain circumstances;
- obligation to report suspected criminal offences; and
- power to take summary criminal prosecutions.

These measures fall into three categories:

- remedial action employed by the RCU to ensure that corrective action is undertaken in a timely manner, particularly through the use of RMPs and the issue of regulatory directions;
- sanctions for regulatory breaches progressed by the Central Bank's Enforcement Division, particularly through the administrative sanctions procedure. RCU refers concerns to the Enforcement Division of the Central Bank that "prescribed contraventions" have been committed for investigation and possible enforcement action; and

- resolution action employed by the SRU using the Central Bank's powers under the Central Bank and Credit Institutions (Resolution) Act 2011.

Depending on the circumstances, sanctioning activities and remedial activities can take place separately or in parallel. Similarly, sanctioning activities and resolution activities can take place separately or in parallel.

GUIDING PRINCIPLE 21.2. The supervisor has the power to act where a credit union falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a credit union to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.

Description and Findings GUIDING PRINCIPLE 21.2: RCU has statutory and non-statutory tools to require credit unions to take corrective action where there are concerns, including concerns as to the solvency of the credit union. Non-statutory powers include the use of an RMP when supervisors become aware of potential issues in a credit union including issues which could result in a credit union falling below its regulatory threshold requirements. This will set out in detail the remedial actions required by the credit union and the date by which those actions are to be taken. Statutory powers are used in more serious cases and include the ability to give regulatory directions regarding a credit union's regulatory threshold requirements as required and to take an action to sanction the credit union under the administrative sanctions procedure. The use of these powers is also considered under Guiding Principles 1, 18 and 22.

GUIDING PRINCIPLE 21.3. The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a credit union to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the credit union, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders, restricting asset transfers, barring individuals from the credit union sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the credit union, and revoking or recommending the revocation of the credit union registration.

Description and Findings GUIDING PRINCIPLE 21.3: The Central Bank has published its *2015 Enforcement Priorities* for all regulated financial service providers, together with a specific priority - governance - for the credit union sector. The Central Bank has emphasised that it will be prioritising enforcement in relation to prudential requirements, timeliness, completeness and accuracy of information submitted to the Central Bank, systems and controls deficiencies and governance issues, among other matters. The Central Bank also issues RMPs which provide clear prudential objectives with actions to be undertaken by the relevant credit union.

Where supervisors have specific concerns about activities that could pose risks to a credit union, such as weakness in governance and systems and controls for lending and credit control, they may impose restrictions on the business of the credit union, such as restricting the level of investment or lending undertaken. Lending restrictions tend to limit individual loan size or on commercial lending activity and in some cases, a limit on the total lending permitted each month.

Where the supervisor's concerns are not addressed by the credit union and a significant risk still exists, a regulatory direction may be imposed to further restrict the business of that credit union. The Central Bank has powers in relation to giving regulatory directions and includes the ability of the Central Bank to:

- restrict or suspend payments to members;
- withhold approval of new activities or acquisitions;
- restrict asset transfers; and
- restrict the current activities of the credit union.

A credit union wishing to merge with, or acquire, another credit union, must obtain approval from the Central Bank, whose powers to approve credit union mergers/acquisitions are contained in the 1997 Act. This question is considered in more detail under Guiding Principle 23 (Major Acquisitions).

The Central Bank has the power to suspend or revoke the registration of a credit union under the 1997 Act but since the commencement of the Central Bank and Credit Institutions (Resolution) Act 2011 the powers in the latter Act, being more comprehensive, have been used in resolution cases rather than those in the 1997 Act.

The Central Bank also has significant powers in relation to individuals in the credit union sector, including power to restrict and disqualify individuals under the *Fitness and Probity* regime (which will apply to all credit unions, irrespective of size, from 1 August 2015) and under the

Central Bank's administrative sanctions procedure whereby "persons concerned in the management" of a credit union may be sanctioned for participation in the commission of a prescribed contravention.

Assessment of GUIDING PRINCIPLE 21: Compliant

Comment: Supervisors' aim in their work is "to ensure credit unions comply with regulatory requirements and guidance" and, wherever possible, supervisory tools will first be directed at bringing a credit union back into compliance rather than sanctioning it.

Supervisors have welcomed the provision of a comprehensive range of powers to the Central Bank, largely in consequence of the work of the CCU, but they recognize that their new powers must be used proportionately and that credit unions will require a period of adjustment to the impact of the new regime. They find the Fitness and Probity regime and the, now-expanded, availability of administrative sanctions for non-compliance with the provisions of the 1997 Act or any conditions, regulations or requirements imposed on credit unions under that Act, powerfully persuasive tools. They have also noted that the publication of the imposition of administrative sanctions can be effective in raising awareness in the sector.

Supervisory tools, for example Regulatory Directions, are relatively straightforward and are subject to proportionate levels of control, so that while the required process is a robust safeguard it is not a disincentive to their use. Should a Regulatory Direction be breached or ignored, in deciding the most appropriate action to be taken, the matter would be discussed with the Central Bank's Legal and Enforcement divisions. In the most extreme cases it could be decided to pursue a summary criminal prosecution, since breaching a direction is a criminal offence. Some relatively minor issues, such as the imposition of a penalty for the late submission of returns, do require a possibly-disproportionate amount of effort but, nevertheless, the Central Bank is prepared to use such tools where the degree of offending demands that they do so.

At present, there are lending restrictions in place in c. 53% of credit unions; fewer than 10% of all credit unions have a restriction in place limiting the total amount of lending within the month but c. 35% of all credit unions have a restriction on commercial lending. These restrictions are presently undergoing supervisory review whereby affected credit unions that consider that they have made the necessary improvements, and have embedded them in robust risk sensitive lending practices, may apply for a review of their lending restriction.

RCU holds regular meetings with the Central Bank's SRU to discuss the position of credit unions whose financial stability is most at risk. If specified conditions are met, the resolution regime prescribed by the 2011 Act allows the Central Bank to seek an appropriate order from the High Court. These powers have subsequently been used, for example, to appoint a special manager (Newbridge Credit Union), to direct a transfer (Howth Sutton Credit Union and Killorglin Credit Union) and to liquidate a credit union (Berehaven Credit Union).

GUIDING PRINCIPLE 22: GOVERNANCE

The supervisor determines that credit unions have robust governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the credit union boards' and management, and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the credit union.

GUIDING PRINCIPLE 22.1. Laws, regulations or the supervisor establish the responsibilities of the credit union's board and management with respect to governance to ensure there is effective control over the credit union's entire business. The supervisor provides guidance to credit unions on expectations of sound governance.

Description and Findings GUIDING PRINCIPLE 22.1: A new statutory governance framework was introduced for credit unions on 11 October 2013 when certain sections of the 2012 Act amended the 1997 Act. Additional governance requirements were introduced on 3 March 2014, completing the introduction of a comprehensive and detailed governance framework for the credit union sector. The 1997 Act provides that a credit union should have governance arrangements that ensure there is effective oversight of its activities. These governance arrangements must take into consideration the nature, scale and complexity of the business being conducted by the credit union.

The 1997 Act provides the following requirements for credit unions: clearly defined roles and responsibilities; performance management, succession planning and remuneration; strategic plan; risk management system; internal audit function; annual compliance statement; and BOC. The Governance Chapter in the *Credit Union Handbook* provides additional guidance.

GUIDING PRINCIPLE 22.2. The supervisor regularly assesses a credit union's governance policies and practices, and their implementation, and determines that the credit union has robust governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires credit unions to correct deficiencies in a timely manner.

Description and Findings GUIDING PRINCIPLE 22.2: During on-going supervision, governance is assessed for all credit unions. Credit unions are required to submit an annual compliance statement with the Central Bank, providing information on compliance with the requirements of Part IV of the 1997 Act. Where a credit union identifies material non-compliance with these requirements, it must submit a Report of Material Non-Compliance to the Central Bank. Follow-up action is taken by the supervisor as appropriate.

In addition to on-going supervision, under PRISM an assessment of governance is undertaken for Medium High and Medium Low Impact credit unions as part of on-going on-site engagements. There are various methods used when assessing a credit union's governance policies and practices.

Deficiencies identified during the PRISM engagement must be addressed by the credit union in a timely manner with a deadline. Normally, for Low Impact credit unions, elements of governance are reviewed by the off-site financial analysis team using KRIs. During 2015 governance policies and practices will be assessed during credit union engagements that are carried out in line with the Temporary Engagement Model for 2015.

Governance issues are also considered in I&R credit unions as part of the asset review program.

Where credit unions have reported outstanding material governance breaches on the annual compliance statement, quarterly updates are required on actions taken or planned to be taken to remediate the breaches.

GUIDING PRINCIPLE 22.3. The supervisor determines that the credit union's board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting management, plans for succession, and actively and critically oversees management's execution of board strategies, including monitoring management's performance against standards established for them.

Description and Findings GUIDING PRINCIPLE 22.3: Part 3 of the Central Bank Reform Act 2010 introduced a statutory system of fitness and probity for the regulation by the Central Bank of persons performing CFs or PCFs in regulated financial service providers, including credit unions.

On 1 August 2013 a tailored Fitness and Probity regime for credit unions came into effect for credit unions with assets greater than €10m. The regime is being introduced on a phased-in basis, and all credit unions will be brought into the scope of the regime on 1 August 2015. The Central Bank issued *Standards of Fitness and Probity for Credit Unions* (Standards) that apply to all persons performing CFs or PCFs in credit unions with total assets greater than €10 million and following 1 August 2015, for all credit unions.

The Standards are appropriate and explain what is expected.

Under the Fitness and Probity regime for credit unions there are 2 CFs and 2 PCFs. A CF is any person that performs a function that:

- exercises a significant influence on the conduct of the affairs of the credit union; or
- is related to ensuring, controlling or monitoring compliance.

The chair of the board of directors and the manager of a credit union are designated as PCFs.

A credit union is not allowed appoint a person to perform a CF/PCF unless the credit union is “satisfied on reasonable grounds” that the person complies with the Standards and that the person has agreed to abide by the Standards. In addition, a credit union must receive approval from the Central Bank before they appoint a person to PCF position.

On 11 October 2013, new governance requirements were introduced for credit unions in relation to succession planning, strategic planning and responsibilities for executing board strategies, including the following:

- the board of directors shall ensure that there is an appropriate succession plan in place for the management team;
- the nomination committee shall be involved in succession planning for the board of directors;
- the board of directors must set the strategy for the credit union and prepare and adopt a strategic plan; and
- the manager is responsible for implementing the strategies agreed by the board of directors to the standards set out in the strategic plan or as otherwise required by the board of directors.

GUIDING PRINCIPLE 22.4. Supervisors should require effective and timely remedial action by a credit union to address material deficiencies in its governance policies and practices, and should have the appropriate tools for this. Supervisors should have a range of tools and their disposal to address material governance deficiencies of a credit union, including the authority to compel appropriate remedial action. The choice of tool and the timeframe for any remedial action should be proportionate to the level of risk the deficiency poses to the safety and soundness of the credit union. When the supervisor requires remedial action, a timetable should be established for completion. Supervisors should have escalation procedures in place to adequately address the deficiencies identified where further action is warranted.

Description and Findings GUIDING PRINCIPLE 22.4: Supervisory tools exist which are used to require effective and timely remedial action by credit unions to address material deficiencies in governance policies and practices, taking into account the specific circumstances including the seriousness of the issue. Timelines are put in place and where matters are not addressed by the credit union, further action is taken. The Central Bank's methods and powers to intervene to address breaches of requirements of the 1997 Act, including governance requirements, are set out in Guiding Principle 21. The Central Bank has specific powers where issues arise in relation to Fitness and Probity and these are also referred to in Guiding Principle 21.

GUIDING PRINCIPLE 22.5. Supervisors should cooperate with other relevant supervisors in other jurisdictions regarding the supervision of governance policies and practices. The tools for cooperation can include memorandum of understanding, supervisory colleges and periodic meetings among supervisors. Information shared should be relevant for supervisory purposes and be provided within the constraints of applicable laws. Special arrangements, such as a memorandum of understanding, may be warranted to govern the sharing of information among supervisors or between supervisors and other authorities.

Description and Findings GUIDING PRINCIPLE 22-5: The Central Bank recognizes the importance of cooperation with other relevant supervisors in other jurisdictions. Periodic meetings on legal and regulatory policy matters have been held with supervisory authorities in other jurisdictions, and management of RCU have attended relevant international conferences (e.g. ICURN).

Assessment of GUIDING PRINCIPLE 22: Compliant

Comment: A new detailed statutory governance framework for credit unions which introduced a number of new requirements and functions was introduced on 11 October 2013. Additional governance requirements were introduced on 3 March 2014, completing the introduction of a comprehensive and detailed governance framework for credit unions. This new statutory framework establishes clearly defined roles and responsibilities, a BOC, and additional requirements relating to internal audit, compliance, risk management, strategic planning, performance management and succession planning. In addition, the Central Bank has introduced Fitness and Probity Standards for designated functions, including the manager, chair, directors and management for credit unions with total assets greater than €10m (1 August 2013). The Standards will apply to all credit unions on 1 August 2015 and will be fully implemented for all credit unions in 2016. The Central Bank has provided comprehensive guidance on all these new requirements.

To date there has been limited experience on the nature and extent of the implementation of recent governance framework in Low Impact credit unions except for any material deficiencies noted in the new annual compliance statement. The 2015 Temporary Supervisory Engagement Model will involve an engagement with Low Impact credit unions, including a review and assessment of governance policies and practices as appropriate.

Recommendation: A new comprehensive risk management and governance framework for all credit unions, which introduced a number of new requirements and functions, has only recently been introduced over a relatively short timeframe. While the Central Bank has engaged with the sector on all recent changes and introduced extensive guidance on the new requirements, it is apparent that these changes are not yet fully understood by the credit union sector and will likely take some time to be effectively implemented. Given the extent of the regulatory changes, the Central Bank should consider expanding its on-site engagements with credit unions to foster greater awareness and understanding of key requirements, formulate expectations and help ensure that any material weaknesses can be appropriately addressed within a suitable timeframe.

The Central Bank may also wish to work with the credit union sector in developing sample tools and/or best practices to supplement their risk management and governance guidance that may help smaller credit unions, in particular to more readily implement suitably scaled approaches.

GUIDING PRINCIPLE 23: MAJOR ACQUISITIONS

The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions by a credit union, against prescribed criteria.

GUIDING PRINCIPLE 23.1. Laws or regulations clearly define: (a) what types and amounts (absolute and/or in relation to a credit union's capital) of acquisitions and investments need prior supervisory approval; and (b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to credit union business and where the investment is small relative to the credit union's capital.

Description and Findings - GUIDING PRINCIPLE 23.1: The 1997 Act sets out powers of the Central Bank to approve credit union mergers/acquisitions. Where credit unions wish to merge/acquire other credit unions there are two options under the 1997 Act. Credit unions may amalgamate or a credit union may transfer its engagements to another credit union. To date, all mergers/acquisitions have been by way of transfer of engagements. Where one credit union transfers its engagements to another credit union, this can be classified as a "major acquisition" in the context of this Guiding Principle. The legal framework for credit unions, including the membership and common bond requirements, does not facilitate the acquisition of other types of businesses by credit unions.

Under sections 128 and 129 of the 1997 Act, all transfer of engagements or amalgamation must be confirmed by the Central Bank prior to the transfer/amalgamation taking place.

GUIDING PRINCIPLE 23.2. Laws or regulations provide criteria by which to judge individual proposals

Description and Findings - GUIDING PRINCIPLE 23.2: Section 131 of the 1997 Act provides for the application process for the confirmation of a transfer of engagements or amalgamation by the Central Bank.

The Central Bank has developed criteria and issued guidance on its process for the assessment and approval of voluntary transfer of engagements, including legal and regulatory requirements, supporting documentation, sample timeframes and sample templates.

All applications for transfers of engagements are subject to the same assessment process within the Central Bank and all assessments are carried out in advance of any transfer of engagements. The key steps include an initial assessment of the high level business case, an

asset review, due diligence, detailed business plan including integration plan, legal process and deregistration.

The high level business case must include the major reasons and benefits to the members of the transfer, financial projections including major assumptions, and estimated costs.

The Central Bank assesses individual proposals on a case by case basis. Key criteria include benefits to the membership, strategic fit, risk profile, asset and loan quality, quality of governance and risk management practices, and future viability. The Central Bank will permit the transfer to proceed if there are no serious concerns raised by the proposed transfer on review of the documentation listed above which cannot be mitigated to the satisfaction of the Central Bank (pre or post the transfer as appropriate).

The Irish Government established CCU in 2011 to review the future of the credit union movement and make recommendations in relation to the most effective regulatory structure for credit unions. A core recommendation of CCU was that the credit union sector should be restructured and that this should be achieved on a voluntary, incentivized and time-bound basis. Arising from this recommendation a statutory body, ReBo, was established as an independent body was set up to facilitate and oversee the restructuring of credit unions in accordance with Part 3 of the 2012 Act. RCU continues to have the legal responsibility to confirm any transfer of engagements in accordance with the 1997 Act.

ReBo is actively involved in communicating its services for assisting in all steps of the merger process and has developed a comprehensive Merger Handbook with the help of the Central Bank. The Merger Handbook sets out all the necessary steps and considerations for credit unions to complete an effective transfer of engagements. The Merger Handbook also provides various supporting templates and sample documents ranging from the high level and detailed business cases, cost budgets, due diligence, integration plan, and application for confirmation.

At the time of the review, 36 credit unions (transferor) had transferred their engagements to another credit union (transferee) since 2010. A number of other transfers that are currently underway also involve two or more credit unions transferring their engagements to another credit union at the same time. The majority of these transfers have been facilitated by ReBo.

The 2012 Act provides the Minister for Finance will review the operation of ReBo not later than 1 January 2016, and after consultation with the appropriate persons, determine whether ReBo has completed the performance of its functions. Where the Minister for Finance is satisfied that ReBo has completed the performance of its functions, he may dissolve ReBo.

GUIDING PRINCIPLE 23.3. Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the credit union to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future. The supervisor can prohibit credit unions from making major acquisitions/investments in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.

Descriptions and Findings - GUIDING PRINCIPLE 23.3: As part of the assessment of the suitability of the transfer of engagements proposal, the Central Bank ensures that any transfer of engagements would not expose the credit union to undue risks or hinder effective supervision in the future. This includes an assessment of areas of potential risk, including an assessment of the combined entity's ability to comply with regulatory requirements and the proposed governance structure.

The criteria against which any proposal for a transfer of engagements is assessed is set out in an internal process document and the Approval Memo (which is sent to the Registrar of Credit Unions for approval/review in relation to the proposed transfer of engagements). The Central Bank also assesses, through a detailed examination of all information provided as part of the proposal that, based on the information available, the transfer of engagements is not likely to hinder the effective implementation of required supervisory actions in the future and ensures the protection of members' savings.

Group/Cross-Border operations

Credit unions are autonomous entities that cannot operate on a group or cross border basis. As a result, the Central Bank does not need to prohibit credit unions from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision or to take into consideration the effectiveness of supervision in the host country or its own ability to exercise supervision on a consolidated basis.

Assessment of GUIDING PRINCIPLE 23: Compliant

Comment: The Central Bank ensures that any transfer of engagements would not expose the credit union to undue risks or hinder effective supervision in the future. This includes an

assessment of areas of potential risk, including an assessment of the combined entity's ability to comply with regulatory requirements and the proposed governance structure. The time period for transfer of engagements using the existing structure varies and can typically range from 6 to 9 months from inception to completion. Transfer of engagements completion timelines can also be impacted by a number of other factors including credit unions own timelines and plans and the nature and complexity of issues in the credit unions involved.

Recommendation: The transfer of engagements process, including assessment criteria and supporting documentation and requirements generally applies to all credit unions regardless of size. This is a fairly comprehensive and time consuming process for the credit unions and Central Bank/ReBo which may inhibit restructuring efforts. During the current restructuring phase of Irish credit union sector, the Central Bank may wish to consider modifying the assessment process and criteria where appropriate. For example, a more streamlined process may be appropriate for transfer of engagements between larger and smaller credit unions where the assets of the transferor credit union(s) are significantly lower than the assets of the transferee credit union and where there are no material outstanding risk issues of the transferee.

The ReBo Merger Handbook which sets out details on the process is a useful document for credit unions. It may be helpful to retain its structure, suitably modified and published as a Central Bank document, after the Minister for Finance dissolves ReBo when he is satisfied that, following a review, ReBo has completed the performance of its functions.