Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

PRISM Supervisory Commentary 2020

Registry of Credit Unions

September 2020

Contents

1. Foreword

I am pleased to present this Foreword to our fourth edition of the PRISM Supervisory Commentary. The purpose of the PRISM Supervisory Commentary is to inform all credit unions on the nature and type of risk issues identified arising from our 2019 supervisory engagements. In this edition of the Commentary, we set out evidence-based findings across the key risk areas and outline our associated supervisory expectations.

Firstly, I want to acknowledge that COVID-19 engenders unprecedented challenges for all of us. As noted in the Central Bank's second 2020 Quarterly Bulletin, the future path of the pandemic, in particular its scale and duration, is unknown, and, as a result, there is considerable uncertainty about both the potential depth and persistence of the downturn currently underway, and also the likely timing and speed of an eventual recovery. The credit union sector overall came into the crisis with a relatively strong financial position in terms of capital and liquidity, albeit with ongoing viability concerns for many individual credit unions. It is commendable that all credit unions have continued to serve their members' needs in these difficult circumstances including ensuring continuity in provision of services to members. However, given pre-existing commercial/sustainability challenges for individual credit unions and the additional challenges presented by COVID-19 and Brexit, credit unions will need to take steps to strengthen operational resilience and protect and support their financial position in order to meet the significant challenges that lie ahead.

For the Central Bank, this underlines the importance of prudent balance sheet management on the part of credit union boards, the benefit of ex-ante business continuity planning by credit unions, and the importance and benefit of our continued supervisory engagement on this risk area. Credit union financial and operational resilience aligns with our statutory mandate towards the sector, in terms of both the protection of member funds and the broader financial stability and well-being of credit unions.

The commercial and resulting sustainability challenges, which pre-date COVID-19, have contributed to the imbalance between lending and savings that individual credit unions are continuing to experience. The economic outlook presents further challenges arising from the expected downward direction of the economic cycle on foot of COVID-19 and other potential negative economic impacts (e.g. Brexit). In this environment, it is fundamentally important that credit unions maintain a prudent approach to all aspects of their business including lending, investments, liquidity and capital, that is aligned with risk appetite and underpinned by strong governance, operational capabilities and risk management frameworks.

Strong core foundations across governance, risk management and operational capabilities will enable credit unions to continue to provide core services to members and undertake prudent business model development in line with their strategy, capabilities and risk appetite. Good governance and robust risk management are necessary and critical business enablers in this increasingly challenging environment and accordingly will remain a key focus of our supervisory strategy. Coherent and considered strategic planning is required if individual credit unions are to address the commercial challenges they face.

This publication is designed to support credit union boards and management teams in reviewing and embedding improved governance, risk management and operational frameworks. We are encouraged *to see some examples of effective governance. However, we continued to identify examples of fundamental governance weaknesses during our supervisory engagements. It is a source of prudential concern that we have continued to identify similar types of risk issues across our supervisory engagements each year, which evidences a lack of significant progress in the evolution of core foundations across governance, risk management and operational capabilities in some credit unions. Accordingly, we now urge all credit unions to consider all of the findings in this report, how they may relate to their business and, where they arise, to implement on a timely basis the necessary changes to mitigate these risk issues. Two areas of risk that stand out, particularly in the context of the challenges the sector is facing and the sector's desire to evolve the business model, are credit risk and operational risk.*

Specifically, it is of concern that during our 2019 supervisory engagements and at a time when so much sector advocacy centres on credit union lending capacity, we continued to identify basic fundamental weaknesses in credit frameworks and underwriting practices in many credit unions. These weaknesses included inconsistencies between stated strategy and risk appetite and credit policies. Additionally, weaknesses in credit policies and their implementation were identified - with divergence between credit policies and actual credit practices noted in some cases. The revisions to the lending framework, which we introduced at the start of 2020, provide a framework that is responsive to enhanced competence and capability. It is now a matter for credit unions to avail of the additional lending capacity provided, where they can demonstrate that they have the competence and capability to operate this business on a sustainable basis.

From an operational risk perspective, credit unions have become more reliant on increasingly complex IT systems and outsourced service providers to conduct their business and deliver services to members. Deficiencies were identified in IT frameworks, the management of IT risk and the management and oversight of outsourced providers in a number of larger credit unions that were inspected. This highlights the need for a focus on developing capabilities to support more complex services and to effectively manage associated IT risks. Where credit unions have extended their processes in recent times to facilitate remote working and/or to provide remote access of services to members, processes and controls, including security measures, should be reassessed and the associated operational risks managed accordingly.

We expect that the findings set out in this report under each of the risk areas be considered by all credit unions, in the context of assessing the adequacy of their own risk management framework and determining appropriate and timely actions to mitigate risks. This will enable credit unions to mitigate risks so that they are better placed to serve their members' needs in a safe and sustainable manner.

Patrick Casey

Patrick Casey
Registrar of Credit Unions
September 2020

2. Executive Summary

The PRISM Supervisory Commentary 2020 provides an overview of seven risk categories of the Central Bank's PRISM[1] framework where risk issues were identified in credit unions. The commentary is based on almost 550 individual risk issues, identified by the Registry of Credit Unions (RCU) during our 2019 PRISM supervisory engagements. These risk issues formed the basis for almost 90 Risk Mitigation Programmes (RMPs) which were issued to credit unions between January and October 2019.

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

In line with previous editions of the PRISM Supervisory Commentary, we set out our supervisory expectations across the PRISM risk categories. Additionally, section 7.4 of the Operational Risk section of this report sets out findings from more detailed IT risk assessments that were carried out, with the assistance of Central Bank IT risk specialists, in a number of larger credit unions as part of Full Risk Assessments in 2019, findings which will be relevant to all credit unions.

The PRISM Supervisory Commentary is intended to be a practical reference tool for all credit union boards and management teams to support enhancement of governance, risk management and operational frameworks. We therefore encourage all credit unions to consider the findings presented as part of their own ongoing management and mitigation of risk.

Governance Risk

We are encouraged to see some examples of effective governance where boards can demonstrate strong leadership and oversight of the credit union, including board ownership of risk management. However, we continued to identify examples of fundamental governance risk issues during our supervisory engagements, and it is notable that the largest proportion of risk issues identified in credit unions continue to be under the governance risk issue category, as was the case in each of our previous three editions of the PRISM Supervisory Commentary.

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

Key governance risk issues identified include:

- Evidence of inconsistencies and contradictions between stated risk appetites and the policies, procedures and practices of some credit unions, reflecting a failure to ensure the activities of the credit union align with its strategy and stated risk appetite.
- General policy weaknesses. These included lack of specific policies, insufficient detail in policies – for example setting out limits in policies that are based on regulatory limits and not tailored to the credit union's own business model / risk appetite statement and a failure to regularly review and update policies.
- Weaknesses in the risk management and compliance frameworks within credit unions, with evidence of failure to adequately resource and oversee these key functions and a failure of boards to effectively engage with them.

Credit Risk

Credit risk remained a key area of focus during our supervisory engagements with credit unions. As highlighted in Issue 6 of the *'Financial Conditions of Credit Unions'*, published in December 2019, it is notable that there has been a shift in loan portfolio profile with an increase in the level of lending greater than 5 years and an increase in the individual value of new loans. Such a move to longer term and/or larger scale loans should be aligned with a credit union's strategy and risk appetite, and supported by appropriate credit policies and procedures. It is concerning that we continued to identify fundamental weaknesses in credit underwriting during our 2019 supervisory engagements. As articulated in the Feedback Statement to CP125, one of the factors that informed the calibration of the new lending limits for house and business lending was the level of competence and capability in credit unions, and that evidence of improved competence and capability would be required to support additional lending capacity in these types of lending in the future. Our supervisory engagements suggest further advancement is required at individual credit union level in that regard.

Key credit risk issues identified include:

- Inconsistencies between stated strategy and risk appetite and credit policies.
- Weaknesses in credit policies and oversight of credit functions were identified – with divergence between credit policies and actual credit practices noted.
- Evidence of poor underwriting identified, including failures to assess accurately the repayment capacity of members and issues concerning critical credit metrics (i.e. inaccuracies in debt-to-income ratios).

Operational Risk

Deficiencies in core processes and frameworks were noted by supervisors during supervisory engagements. Growing operational complexity increases risk vulnerabilities for credit unions through Information Technology (IT) and other outsourcing arrangements and requires robust operational risk frameworks to identify and mitigate consequential risks effectively. It is notable that deficiencies were identified in IT frameworks, the management of IT risk and the management of outsourced providers in a number of larger credit unions – issues that would need to be addressed to support more complex services and to effectively manage associated IT risks.

Key operational risk issues identified include:

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

Strategy/Business Model Risk

It is evident from our supervisory engagements during 2019 that maintaining a clear strategic focus remained a challenge for some credit union boards. Coherent and considered strategic planning is required if individual credit unions are to address the commercial challenges they currently face, reflective of a changing operating environment.

For weaker credit unions with viability challenges that, as a consequence, are not servicing all member needs, alternative strategies may be necessary, including the need to engage with larger, stronger credit unions, to ensure continuity in the provision of existing and additional services to members.

Key strategy/business model risk issues identified include:

- Concerns with the quality of strategic planning with examples of boards failing to identify and address the key challenges faced by the credit union as part of the process.
- Specific weaknesses identified in strategic plans included: insufficient detail, lack of specified time-frames and assigned responsibilities for stated objectives and failure to include measurement criteria for objectives identified.
- Evidence of viability concerns in a number of cases across smaller credit unions, with the risk that the credit union will not be able to generate a surplus in the short to medium term not being recognised and addressed through the strategic planning process.

Investment, Liquidity and Capital Risk

While the risk issues identified in relation to investment, liquidity and capital risks represented a relatively small proportion of findings in the sample of credit unions subject to review during the period, these are key areas for all credit unions to keep under review.

Key investment, liquidity and capital risk issues identified include:

- Weaknesses in liquidity and reserve management policies.
- Examples of shifts in the risk profile of investment portfolios without evidence of detailed consideration and discussion on these decisions at board level.

Credit unions should ensure that detailed analysis and careful consideration is undertaken before making any investment decisions to ensure associated risks are fully understood and considered. Careful consideration should be given to any potential shift in the risk profile of a credit union's investment portfolio including an extension in the maturity profile or the introduction of new counterparties.

Adequate reserves are necessary to support a credit union's operations, provide a base for future growth and protect against the risk of unforeseen losses. Credit unions need to maintain sufficient reserves to ensure future sustainability and to protect members' savings. Adequate reserves are key to maintaining member confidence and on-going sector stability. Given the level of risk and uncertainty regarding the economic outlook, the Central Bank expects credit unions to maintain a conservative approach to reserve management.

Summary

In summary, while it is encouraging to note evidence of improvements in governance frameworks in some credit unions we continued to identify some fundamental issues across governance, credit, operational risk and business model risk in many credit unions. It is a significant source of prudential concern that we have continued to identify similar types of risk issues during our supervisory engagements each year, evidencing a lack of progress in the evolution of core foundations across governance, risk management and operational capabilities. We are concerned to see similar issues being repeatedly identified in relation to:

- Credit underwriting;
- Bank and cash control frameworks;
- Anti-money laundering frameworks; and
- Internal audit.

These are key areas where we have focused supervisory attention and previously articulated our supervisory expectations. Shortcomings in key risk areas are concerning, particularly given the ongoing narrative at sector level from those who represent credit unions, to transform the business model through the provision of new products and services, including the provision of increased levels of house and business loans. It is clear that some credit unions, who want to prudently develop their business models to incorporate an increased level of longer term lending, will need time to build the required competence and capability to do so. Strengthening of core foundations in the areas of governance, risk management and operational capability, in order to address key risk vulnerabilities, remains essential to enable prudent business model transition in credit unions. We expect to see evidence of improvements being embedded by credit unions in our future supervisory engagements.

3. Methodology

Risk-based supervision, carried out under the PRISM framework, is fundamental to our execution of the Central Bank's statutory mandate[2] to administer the system of regulation and supervision of credit unions with a view to ensuring protection by credit unions of the funds of its members, as well as the maintenance of the financial stability and well-being of credit unions generally. PRISM enhances our ability to deliver judgement-based, outcome-focussed supervision for the sector.

Supervisory Proportionality

In 2019 we refined our supervisory approach to differentiate proportionately between ***small and medium credit unions*** (up to €100m total assets) and ***large credit unions*** (over €100m assets). In delivering our approach of supervisory proportionality, our expectations are highest for larger credit unions and those with more complex business models.

Credit union size, combined with risk profile, are the drivers of the frequency of inspections and engagements enabling us to proportionately differentiate between credit unions of differing asset sizes and risk profiles. In 2019 our supervision of the largest credit unions continued to involve regular onsite inspections. For credit unions with assets below €100m, we applied a desk-based supervisory approach, albeit that some targeted on-site inspections occurred in this population of credit unions with higher risk profiles.

The application of a proportionate risk-based approach to supervision means that some risk areas in certain credit unions are inspected more intensively than others.[3] Supervision teams scope the inspection based upon the risk profile of the particular credit union, informed by risk indicators and previously identified risk issues. This approach has an impact on the type and nature of supervisory findings, as increased risk vulnerabilities may be identified in those areas that are reviewed with greater intensity.

Similarly, it should be noted that the absence of identification of particular risk issues in a particular asset classification does not indicate that the particular risk issue is not present in that asset classification, rather it may not have been identified due to the planned focus of our supervisory engagement at that time. Accordingly, we recommend that all credit unions should

[2] Section 84 of the Credit Union Act 1997.

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

consider both the findings in relation to their own asset classification, as well as the findings in relation to the other asset classification.

Presentation of Findings

This Supervisory Commentary is based on 547 individual risk issues, identified across seven risk categories of the PRISM framework during supervisory engagements by RCU. These risk issues form the basis for 86 individual RMPs issued to credit unions between January and October 2019, following supervisory engagements.

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

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

  These detailed findings set out the risk issues most commonly identified in specific risk areas – the particular risk issues identified may have been identified in some or all of the credit unions in the sample.

Section 7.4 of the report also sets out findings from more detailed IT risk assessments on a number of larger credit unions as part of Full Risk Assessments, findings which will be relevant for all credit unions.

Within each section, the supervisory findings are accompanied by our supervisory expectations related to the specific risks identified in each category of risk[4]. Credit unions should also refer to guidance on supervisory expectations provided in the Credit Union Handbook, a resource which we update regularly and which should be referred to by credit unions on an on-going basis.

[4] Supervisory expectations are drawn from previous communications to credit unions including previous editions of the PRISM Supervisory Commentary.

4. Overview of PRISM Risk Assessment Findings

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

i. **Classification 1 - assets of at least €100m**; and

ii. **Classification 2 – assets of less than €100m.**

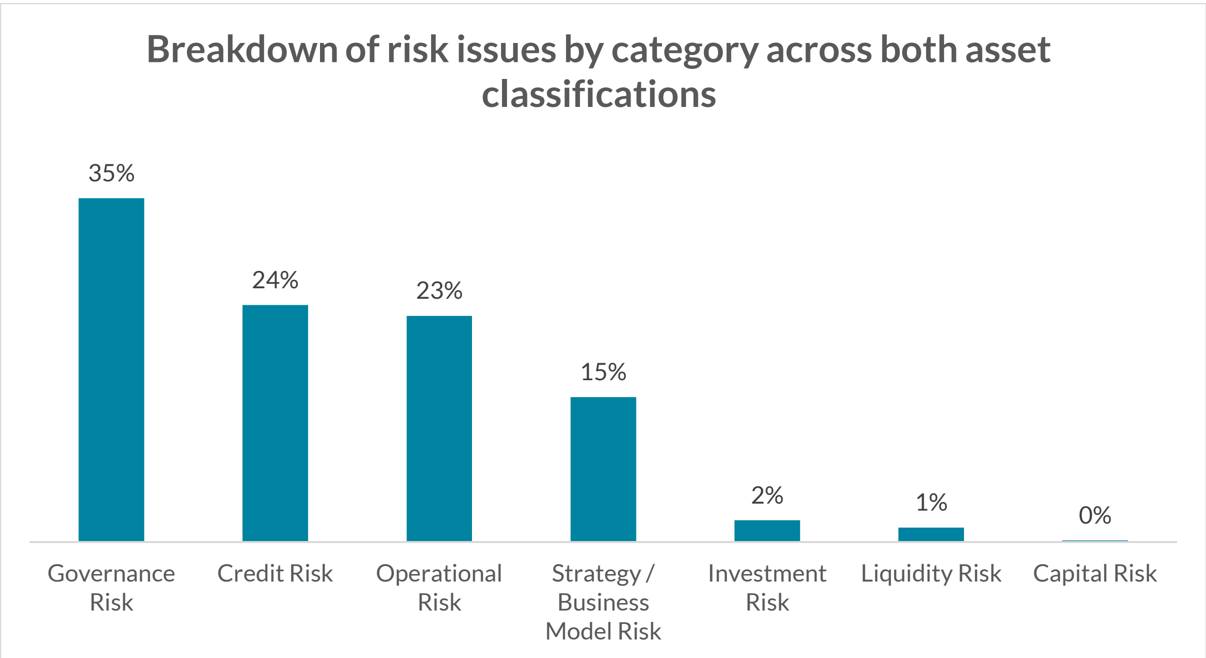
Table 1 below sets out the distribution of the risk issues across the asset classes.

Table 1

Asset Classification	No. of Credit Unions receiving RMP	As % of total credit unions in this asset class[5]	No. of risk issues identified in this asset class
≥€100m	29	51%	248
Less than €100m	57	31%	299
Total	**86**		**547**

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

Figure 1



[5] Figures from Prudential Returns as at 31st December 2019

PRISM Risk Assessment Findings

5. Governance Risk

Overall Supervisory Expectations

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

The risk management framework, in particular, should enable credit unions to identify, manage and mitigate risks to support a more sustainable business model. The current challenging operating environment for credit unions, including both current and emerging risks/impacts from Brexit and the COVID-19 pandemic, highlights the importance of having sound governance and risk management practices within a clearly articulated framework.

We set out specific supervisory expectations related to governance findings from our supervisory engagements in Section 5.3. While these reflect our supervisory expectations for credit unions in both asset classifications we expect that credit unions, in considering how these expectations can inform their approach to identifying, managing and mitigating governance risk issues, should take account of the nature, scale and complexity of their own business.

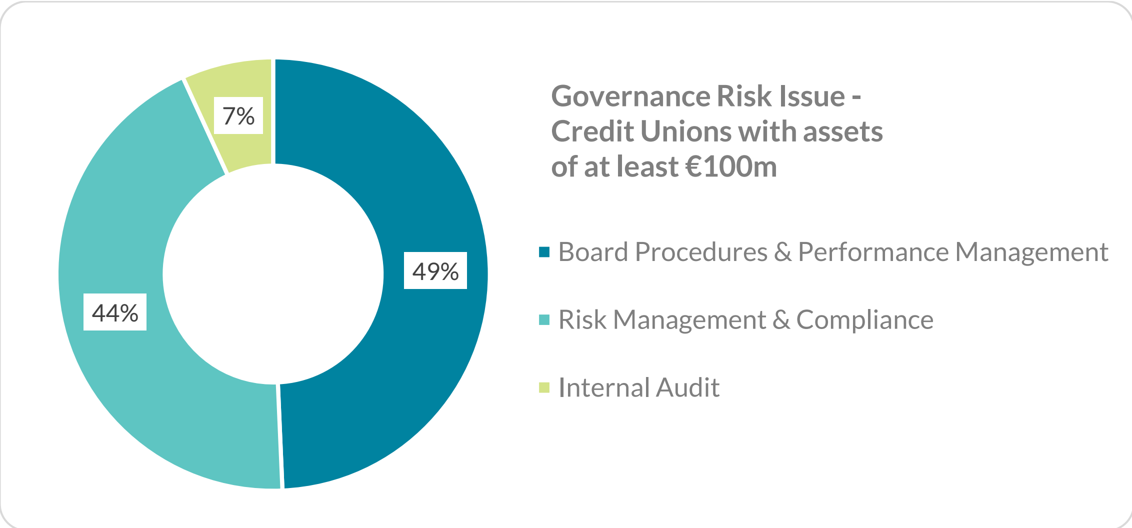
Overall Governance Risk Findings

We found evidence of inconsistencies and contradictions between stated risk appetites and the policies, procedures and practices of some credit unions, reflecting a failure to ensure the activities of the credit union align with its strategy and stated risk appetite. The board maintains ultimate responsibility for the level and type of risks that the credit union is willing to accept in pursuit of its strategic objectives. The policies, procedures and practices of the credit union should reflect the board's stated strategy and risk appetite.

We continued to find examples of failure to adequately resource the key governance functions of risk, compliance and internal audit and examples of boards failing to engage effectively with these functions. Examples of poor quality reporting from these functions were also identified, increasing the risk that key decisions are not necessarily informed by good quality risk and compliance information.

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

Of the 29 credit unions with assets of at least €100m that received an RMP during the review period, 25 credit unions were found to have some governance risk issues. The key governance risk issues identified in this classification of credit unions related to board procedures and performance management, risk management and compliance, and internal audit.



Board Procedures and Performance Management

Following our supervisory engagements with credit unions with assets of at least €100m, we found governance risk issues related to board procedures and performance management in 20 credit unions across the sample of 29[6].

Common risk issues identified in the area of board procedures and performance management included the following[7]:

- ***General policy weaknesses.*** *This included lack of specific policies, insufficient detail in policies, and failure to regularly review and update policies. These weaknesses may ultimately lead to a credit*

[6] Percentages displayed in chart reflect risk issues identified in a specific risk sub -category as a percentage of all risk issues identified in the risk areas – for example risk issues identified in relation to 'Board procedures & Performance management' represent 49% of all governance risk issues identified in credit unions with assets of at least €100m.
[7] These risk issues may have been identified in some or all of the credit unions in the sample - 20 credit unions in the sample of 29 credit unions had at least one such risk issue identified.

union taking on inappropriate risk in various areas such as credit, investments and liquidity. Weaknesses in policies can also result in a lack of clarity regarding internal procedures, and in insufficient reporting to the board, leading to the risk of insufficient board oversight;

- ***Key governance roles not appropriately structured or resourced and key-person risk and succession planning weaknesses.*** *In some cases, this has led to important information not being provided to the board, specific risks not being identified and mitigated, a lack of appropriate independence of roles and segregation of duties. These weaknesses may also result in the board and management team lacking the skillset and experience required to effectively discharge their responsibilities; and*
- ***Failure by the board to formally review the performance of the risk management, compliance and internal audit functions.*** *This may result in a board not being able to satisfy itself that risks are being monitored and mitigated effectively.*

Risk Management and Compliance

We found governance risk issues related to risk management and compliance in 18 credit unions across the sample of 29 credit unions.

Common risk management and compliance risk issues identified in these credit unions included the following:

- ***Failure to implement an effective Risk Management/ Compliance function within the credit union.*** *This included a lack of clarity regarding the role, responsibilities and terms of reference for those involved in the risk management/compliance framework, a lack of segregation of duties/independence as required in these roles, and failure to allocate an appropriate amount of time to these roles, taking account of the credit union's nature, scale and complexity;*
- ***Risk management and compliance reports which were insufficient*** *in terms of detail, failing to highlight key risks, mitigation plans or work plans; and*
- ***Inconsistencies between the documented risk appetite of the credit union and the related policies*** *which implement the risk appetite by setting the parameters for the business activities of the credit union.*

Internal Audit

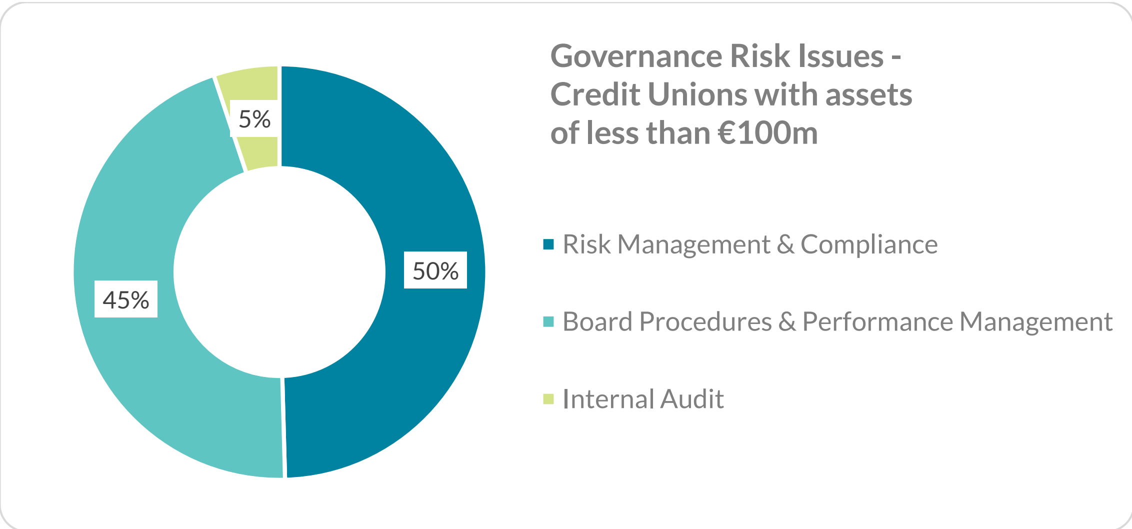
Following our supervisory engagements in credit unions with assets of at least €100m, we found governance risk issues related to internal audit in 5 credit unions across the sample of 29 credit unions.

A common internal audit risk issue identified was:

- ***Shortcomings in the internal audit reports being presented to boards**, failing to reflect the guidance outlined in the Credit Union Handbook. Examples included a lack of detail on audit objectives, scope and approach; lack of commentary on the effectiveness of the functions being tested; lack of evidence of regular reporting to the board on the tracking and reviewing of historic issues, and on the process for escalating and closing such issues; and lack of detail on action deadlines or parties responsible for resolution of issues. This may indicate that the internal audit function is not operating effectively; furthermore, this may hinder the board's ability to oversee these functions in line with their regulatory responsibilities.*

5.2. Governance Risk – Credit Unions with assets less than €100m

Of the 57 credit unions with assets less than €100m that received an RMP during the review period, 42 were found to have governance risk issues. The key governance risk issues identified here were in the same areas as those identified in credit unions with assets of at least €100m but with a higher number in Risk Management and Compliance risks.



Risk Management and Compliance

We found governance risk issues related to risk management and compliance in 38 credit unions across the sample of 57 credit unions.

Common risk management and compliance risk issues identified in these credit unions included the following:

- ***Weaknesses in the risk management and compliance functions.** This included work plans lacking sufficient detail, not being adequately tailored to the credit union's own specific requirements and* *not meeting the minimum guidance outlined in the Credit Union Handbook. These weaknesses increase the potential for insufficient identification of risks and compliance breaches and ineffective risk management processes;*

- ***Weaknesses in risk and compliance reports.*** *This leads to the risk that the board of directors were not being provided with sufficient information to assess whether the credit union was exposed to material risks and/or complying with legislative and regulatory requirements;*
- ***Inconsistencies between documented Risk Appetite and policies****; and*
- ***The top risks, as documented by the credit union, not being reflective of the risk profile of the credit union.*** *This increases the potential for insufficient management of risks, and increases the risk that the board does not have adequate oversight of the risks facing the credit union.*

Board Procedures and Performance Management

Following our supervisory engagements with credit unions with assets less than €100m, we found governance risk issues related to board procedures and performance management in 31 credit unions across the sample of 57 credit unions.

Common risk issues identified in the area of board procedures and performance management included the following:

- ***Failure by the board to formally respond to issues raised in the Risk Management, Internal Audit and Compliance reports.*** *This leads to the risk that recommendations made by the Risk Management Officer, Internal Audit and the Compliance Officer will not be actioned and identified risks mitigated;*
- ***Lack of dedicated resources focused on key challenges facing the credit union.*** *This leads to the risk that the current structure and resourcing level could undermine the credit union's ability to address these challenges; and*
- ***Poor attendance at board of directors meetings.*** *Poor levels of attendance by some directors increases the risk that the board may not be able to fulfil its role and responsibilities effectively.*

Internal Audit

Following our supervisory engagements in credit unions in this classification, we found governance risk issues related to internal audit in 6 credit unions across the sample of 57 credit unions.

A key risk issue identified in this area was the following:

- ***Weaknesses in Internal Audit reports being presented to boards*** *with examples of lack of detail, including failures to outline the work carried out by the Internal Audit function. Failure by Internal Audit reports to provide detailed information on the effectiveness of the internal control framework leads to the risk that the board does not have the necessary information to assess the effectiveness of the internal control framework.*

5.3. Governance Risk – Supervisory Expectations

Board Procedures & Performance Management

- Directors should demonstrate a risk-based mind set, evidenced by an understanding of the ongoing issues raised by each of the risk management, compliance and internal audit functions. Considered and timely responses to issues raised are necessary to complement the work of these functions in ensuring that risks are understood and mitigated. In addition, directors should have in place a mechanism for reviewing the performance of the risk management, compliance and internal audit functions on a regular basis.
- Credit unions should have a detailed succession plan for the board and management team to ensure that the credit union maintains an appropriate level and mix of skills and competencies at non-executive and executive level in order to support the credit union's strategic goals. The succession plan should include arrangements to avoid over-reliance on individuals by providing mechanisms for delegation of responsibility within the credit union, including revolving roles where appropriate.
- Adequate segregation of duties should be in place across the credit union. The clear distinction of roles is fundamental to the delivery of effective governance. Adequate resourcing is important in ensuring adequate levels of independence and separation of duties taking account of the nature, scale and complexity of the credit union. For certain roles to function effectively, e.g. internal audit function, separation from other functions is necessary to avoid conflicts of interests. Such roles must be capable of operating independently of management and without undue influence over their activities.
- All aspects of the operation of the credit union should be supported by clear and comprehensive policy and procedure documentation which detail procedural steps, reporting arrangements, roles and responsibilities etc. as well as the process and timelines for the approval, review and update of these policies. In developing and updating policies, credit unions must ensure that these align with the documented risk appetite and strategic objectives of the credit union.

Risk Management and Compliance

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

Internal Audit

- Credit unions are expected to have a well-resourced, skilled and experienced internal audit function in place, capable of producing reports that are reflective of the individual credit union's nature, scale and complexity. Reports from this function should be of the required standard to add value.
- At a minimum, quarterly reports should be provided to the board which provide a comprehensive objective assessment of the effectiveness of the credit union's risk management framework and internal control and governance processes. Reports should be clear, concise and constructive, in order to assist boards in understanding the issues identified.
- Credit union boards should be cognisant of the issues identified by internal audit. In this regard, we would expect to see evidence of discussion and challenge by the board in relation to issues raised by internal audit. Quality engagement between boards and the internal audit function should ensure issues identified are clearly understood and remediated in a timely manner. Boards should give due consideration to recommendations made by internal audit in their reports and should ensure that there is appropriate follow-up on remediation where weaknesses are identified.

- Boards are required to review the effectiveness of the internal audit function on an annual basis and any shortcomings or deficiencies should be highlighted and addressed as part of this review. This will help to ensure that the internal audit function can add value and aid decision-making in the credit union, given that it represents a key support to boards.
- Credit unions need to ensure that the internal audit function, which is an integral part of the three lines of defence, provides objective assurance to the board on the effectiveness of the credit union's risk management, internal control and governance processes. Where issues are identified, internal audit should make recommendations to the board on improving these with appropriate follow-up to ensure recommendations have been implemented effectively.

6. Credit Risk

Overall Supervisory Expectations

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

Key to prudent lending decisions and to the potential mitigation of credit risk is the assessment of the member's ability to repay. This must be the primary consideration in the underwriting process and the credit union must manage and control lending to ensure the making of loans does not involve undue risk to members' savings. Appropriate procedures for assessing and measuring credit risk will provide relevant information for a credit union board to make judgements about the credit risk of its lending exposures and will facilitate the recognition of losses within the loan book as early as possible. It is important that the level of provisions held for loans is adequate.

In April 2018, RCU published *'Provisioning Guidelines for Credit Unions'*, setting out the Central Bank's expectation on provisioning in credit unions. Credit unions should give due consideration to these guidelines when developing and implementing their provisioning frameworks and when assessing the adequacy of provisions.

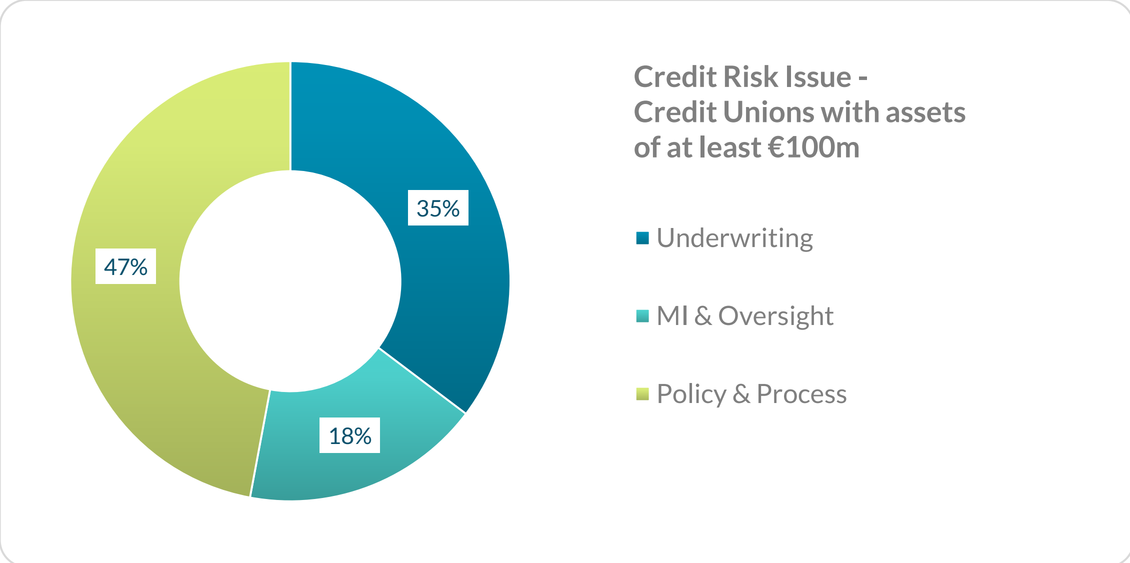
We outline specific supervisory expectations related to credit risk findings from our supervisory engagements in Section 6.3. While these reflect our supervisory expectations for credit unions in both asset classifications, we expect that credit unions should take account of the nature, scale and complexity of their own business in considering how these expectations can inform their approach to identifying, managing and mitigating credit risk issues in their credit union.

Overall Credit Risk Findings

While we continued to see examples of improving credit frameworks in some cases, our findings in relation to credit risk continued to highlight some basic weaknesses in credit frameworks and underwriting practices in many credit unions. These included inconsistencies between stated strategy and risk appetite and credit policies. Additionally, weaknesses in credit policies and their implementation were identified with divergence between credit policies and actual credit practices noted in some cases. We noted failure to assess member repayment capacity accurately, with income and expense items frequently overlooked or omitted during the underwriting process. We also continued to see evidence of inaccuracies in how the debt-to-income ratio is calculated as part of the underwriting process in a large number of cases.

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

Of the 29 credit unions with assets of at least €100m that received an RMP during the review period, 27 credit unions were found to have credit risk issues. The key credit risk issues identified are in the areas of policy & process, underwriting and management information/oversight.



Policy/Process

Following our supervisory engagements in credit unions in this classification, we found credit risk issues related to credit policy/processes in 21 credit unions across the sample of 29 credit unions.

The most common risk issue identified in this area was:

- ***Deficiencies in credit policies**, including:*
  - *A lack of clarity around methodologies used to oversee and report on credit risk;*
  - *A lack of clarity around the assessment process for applications from self-employed members;*
  - *Underwriting requirements for commercial and community loans not being aligned to the Credit Union Handbook; and*
  - *Failures to reflect current legislative requirements and regulations in credit policies.*

These issues could lead to the potential for unacceptable levels of credit risk and incorrect loan classifications.

Underwriting

We found credit risk issues related to underwriting in 14 credit unions across the sample of 29 credit unions.

Common risk issues identified included the following:

- ***Evidence of weak rationales or no documented rationales*** *on file to support lending decisions made by the responsible credit officer;*
- ***Required documentation, e.g. accounts, absent from loan files*** *for self-employed members;*
- ***Examples of failure to successfully secure a first legal charge*** *on house loans issued by the credit union; and*
- ***Absence of Service Level Agreements (SLAs) for legal services*** *related to house loans.*

It is concerning to see such a significant proportion of credit risk issues related to underwriting in these larger credit unions, including some fundamental areas such as the assessment of members' ability to repay and weaknesses in processes to support house lending.

Deficiencies in credit policies and processes increases the risk of credit unions taking on credit risks that are not within stated risk appetite, elevating the risk profile of the credit union's loan book.

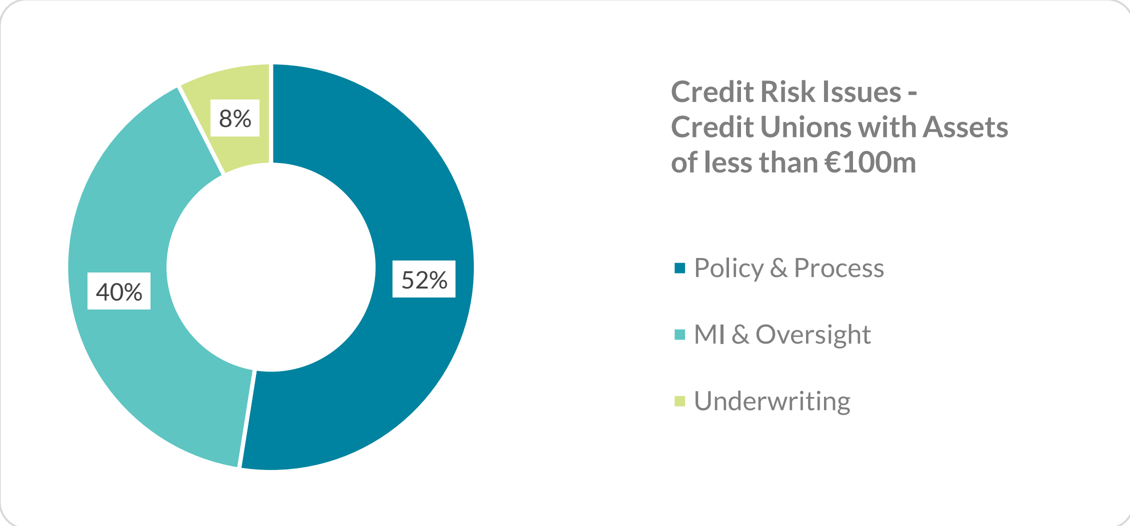
Management Information/Board Oversight

We found credit risk issues related to management information/board oversight in 9 credit unions across the sample of 29 credit unions. Common risk issues identified in the area of management information/board oversight included the following:

- ***Evidence of absence of appropriate board oversight of the credit function****, including a lack of clear reporting on the progress of recovery of loans written off and insufficient detail in reports and minutes provided by the Credit Committee and Credit Control Committee;*
- ***Examples of loans being misclassified****; and*
- ***Inconsistencies between stated risk appetite of the credit union and the credit policy/practices****.*

6.2. Credit Risk – Credit Unions with assets less than €100m

Of the 57 credit unions with assets less than €100m that received an RMP during the review period, 48 credit unions were found to have credit risk issues across the same areas as credit unions with assets of at least €100m. The high number of issues being identified in relation to 'Policy & Process' and 'Management Information/Board Oversight' in this asset classification is considered to be a reflection of the focus of desk-based inspections undertaken in this asset classification. We would encourage credit unions in the less than €100m asset classification to also consider the examples of credit risk issues identified in larger credit unions.



Policy/Process

Following our supervisory engagements in these credit unions, we found credit risk issues related to credit policy/processes in 35 credit unions across the sample of 57 credit unions.

The most common risk issue identified in this area was:

- ***Deficiencies in credit policies****, with policies failing to reflect current regulation or legislative requirements. Examples include:*
    - *Policies lacking detail on repayment capacity assessment, connected borrowers and underwriting of covered loans;*
    - *Absence of procedures to deal with instances of loans not being drawn down within a specific timeframe;*
    - *Policies referencing the potential approval of loans without prior proof of income;*
    - *References to 'Resolution 49[8]' when referring to provision calculations;*
    - *No limit specified on the number of loan top-ups permitted in any one year; and*
    - *Policies lacking clarity on the definition, assessment and monitoring of business loans, community loans and loans to other credit unions.*

Management Information/Board Oversight

Following our supervisory engagements in these credit unions, we found credit risk issues related to MI/board oversight in 27 credit unions across the sample of 57 credit unions.

Common risk issues identified in this area included the following:

[8] Provisioning methodology used prior to introduction of FRS102.

- ***Weaknesses in reports provided to the board****. Examples include Credit Committee and Credit Control Committee reports not containing sufficient financial and other information to enable the board to assess compliance with legal and regulatory requirements, guidance and the credit union's written policies, lack of evidence of reporting on related party lending or on the performance of commercial, community and loans to other credit unions in excess of €25,000;*
- ***Examples of weaknesses in the Risk Appetite Statement in relation to credit****. This included failures to include appropriate qualitative and quantitative lending metrics (e.g. limits in relation to the maximum amount of lending in specific loan categories) in the risk appetite statement;*
- ***Examples of inconsistencies between the risk appetite statement and the credit policies and practices of credit unions****. This included examples of increases in higher-value house and business lending which were not reflected in the risk appetite statement; and*
- ***Absence of/weaknesses in quarterly Loan Book Reviews****: This included lack of commentary supporting the numerical analysis, increasing the risk that loans may not be adequately provided for.*

Underwriting

Following our supervisory engagements in these credit unions, we found credit risk issues related to underwriting in 8 credit unions across the sample of 57 credit unions.

Common risk issues identified in this area included the following:

- ***Lack of evidence of the assessment of a member's ability to repay*** *as part of the underwriting process;*
- ***Examples of errors, miscalculations and omissions when calculating debt-to-income ratios*** *for members, used as part of loan applications; and*
- ***Absence of accounts for self-employed members*** *used as part of the underwriting process.*

Weaknesses in credit underwriting assessment potentially exposes a credit union to undue credit risk and may lead to increased impairments which may have a negative impact on member funds.

6.3. Credit Risk – Supervisory Expectations

Underwriting

- All credit underwriting practices should be in line with policy, which in turn should be fit for purpose and reflect the strategy and risk appetite of the credit union. We expect to find all relevant documentation held on file and clear supporting rationale for the credit decision.

- Where a self-employed member is unable to provide the credit union with audited/certified accounts to verify his/her income, our expectation is that the applicant's accountant confirm details on the financial position of the member.

Management Information/Board Oversight

- Clear management and board oversight of the credit function must be evident including, but not limited to, review of policies and monitoring of the implementation of policies for credit. Reports provided to the board by the credit function must contain sufficient financial and other information to enable the board to assess compliance with legal and regulatory requirements, guidance and the credit union's written policies.
- Credit unions should regularly review provisions to determine their adequacy; quarterly loan book reviews should form part of the objective evidence of impairment when calculating provisions.

Policy/Process

- Credit unions must have well documented procedures in place and these procedures should be followed. We expect to see policies which are reflective of the credit union's strategy and risk appetite statement, as well as relevant legislative and regulatory requirements.
- At a minimum, our expectation is that credit unions require, as part of the underwriting process for a commercial loan of €25,000 or more, a comprehensive business plan and detailed financial projections (supported by evidence-based assumptions), appropriate for the scale and complexity of the loan. Further information can be found in the Lending Chapter of the Credit Union Handbook.

Credit unions are reminded of the January 2018 publication of '<u>House Loans in Credit Unions – Thematic Review Findings</u>', which sets out recommendations for good practice to support the provision of house loans to their members.

7. Operational Risk

Overall Supervisory Expectations

Credit unions have continued to become more reliant on increasingly complex IT systems and outsourcing service providers to conduct their business and deliver services to members. This, combined with expanding branch networks across enlarged credit unions, has increased the operational risk profile of many credit unions.

The risks associated with IT and cybersecurity and the mitigation of these risks is an area of key concern for the Central Bank. Accordingly, we expect that the boards and senior management of credit unions fully recognise their responsibilities in relation to IT and cybersecurity governance and risk management and place these among their top risk areas. It is management's responsibility to understand the range of specific IT related risks that the credit union faces and to ensure that these are sufficiently mitigated in line with the credit union's risk appetite.

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

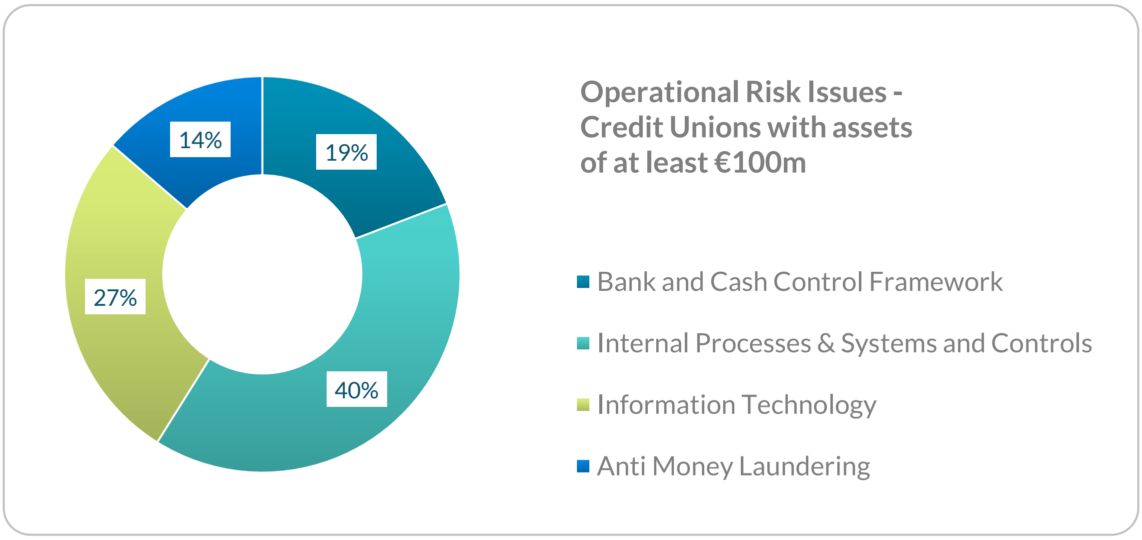
We outline specific supervisory expectations related to operational risk findings from our supervisory engagements in Section 7.3. While these reflect our supervisory expectations for credit unions in both asset classifications, we expect credit unions to take account of the nature, scale and complexity of their own business in considering how these expectations can inform their approach to identifying, managing and mitigating operational risk issues in their credit union.

Additionally, section 7.4 below sets out findings from more detailed IT risk assessments that were carried out, with the assistance of Central Bank IT risk specialists, on a number of larger credit unions as part of Full Risk Assessments in 2019, findings which will be relevant for all credit unions.

Overall Operational Risk Findings

As part of our supervisory engagements during the review period, we continued to find failings in internal controls including deficiencies in systems of control related to bank and cash management and weaknesses in relation to segregation of duties. It was notable that where credit unions had been involved in transfers of engagements, in some cases they had not effectively implemented all actions and recommendations made during the transfer process in relation to the internal control environment required to support the larger entity. Under-resourced IT Functions and frameworks were also identified in some credit unions with weaknesses in IT risk assessment and monitoring. Weaknesses in operational procedures related to anti-money laundering continued to be identified during supervisory engagements.

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



Of the 29 credit unions with assets of at least €100m that received an RMP during the review period, 25 credit unions were found to have operational risk issues. The key operational risk issues identified related to internal processes/systems and controls, information technology, bank and cash control framework and anti-money laundering (AML).

Internal Processes/Systems and Controls

We found operational risk issues related to internal processes/systems and controls in 16 credit unions across the sample of 29 credit unions.

Common risk issues identified in this area included the following:

- ***Internal reporting issues, including discrepancies or inaccuracies in the reporting of pledged/unattached dormant accounts and exceptions reporting.*** *Such inaccuracies could have a material impact on the calculation of provisions and liquidity levels. This also increases the risk of inaccurate information being submitted to the Central Bank;*
- ***Weaknesses in business continuity plans, or plans not being reviewed or updated following testing with failures to reflect any adverse findings or shortcomings in plans following such testing.*** *This gives rise to the risk that the credit union may not have suitable arrangements in place in the event of a disruption to services, and that the essential functions of the credit union may not be able to continue in the event of a material interruption to the business of the credit union; and*
- ***Failure to fully embed or implement actions after completing a Transfer of Engagements process.*** *Failure to effectively address issues, actions and recommendations made, arising from this process, could result in weaknesses in the internal control environment required to support the larger entity.*

Information Technology

We found operational risk issues related to IT in 14 credit unions across the sample of 29 credit unions.

Common risk issues identified in this area included the following:

- ***Lack of an appropriately resourced IT Function / IT Framework.*** *This included weaknesses in internal controls, IT risk assessment and monitoring, and relevant IT policies, a lack of regular testing (e.g. back-ups, penetration, disaster recovery) and also weaknesses in oversight of arrangements with outsourced service providers;*
- ***Inappropriate or excessive access granted to staff members on systems.*** *This could lead to issues regarding the appropriate segregation of duties increasing the risk of fraud and data breaches; and*
- ***Failure by credit unions to maintain an IT asset register.***

As part of our 2019 supervisory engagements programme we undertook Full Risk Assessments in a number of credit unions with assets of at least €100m. This work, which included an element of focus on IT risk, was supported by Central Bank IT risk specialist supervisors. Further detail on the findings of this aspect of work is set out in section 7.4 below.

Bank and Cash Control Framework

We found operational risk issues related to the bank and cash control framework in 13 credit unions across the sample of 29 credit unions. The findings related to bank and cash control frameworks in credit unions with assets of at least €100m give rise to key concerns, in particular in respect of some basic control measures surrounding the core area of operations.

Common risk issues identified in this area included the following:

- ***Weaknesses in the documented procedures in place for bank and cash reconciliations within the credit union.*** *This included a lack of evidence of dual review of bank reconciliations and inconsistent practices across branches. This may lead to the risk of insufficient oversight of the bank reconciliation process and to the risk of internal ledger records not accurately reflecting the members' funds position; and*
- ***Concerns regarding cash management and movement procedures*** *which could give rise to some heightened risks in this area.*

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

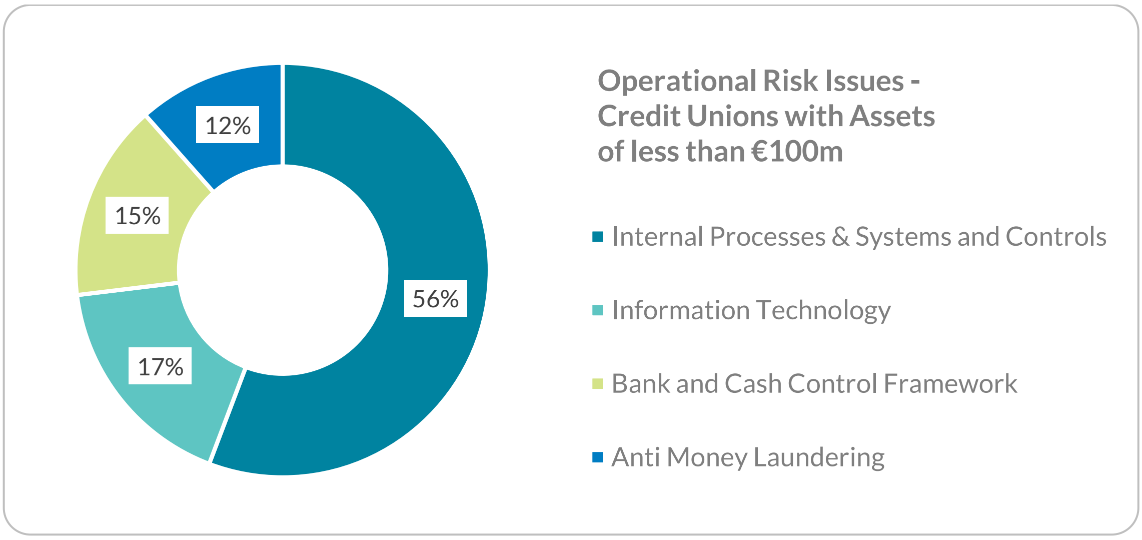
We found operational risk issues related to anti-money laundering in 9 credit unions across the sample of 29 credit unions.

The most common risk issue identified in this area was:

- ***Weaknesses arising from incomplete customer due diligence (CDD) documentation.*** *Specific risk issues included a lack of regular status reporting, setting out the number of members with up to date CDD, and in some cases the absence of a clear action plan to address out-of-date CDD documentation. Weaknesses in AML controls can lead to the risk that the board are unaware of the level of compliance with AML and CTF provisions, and may expose the credit union to an unacceptable risk of money laundering and terrorist financing.*

7.2. Operational Risk – Credit Unions with assets less than €100m

Of the 57 credit unions with assets less than €100m that received an RMP during the review period, 52 credit unions were found to have operational risk issues a high proportion of issues identified related to 'Internal Processes & Systems and Controls' reflecting the focus of our desk based engagements.



Internal Processes/Systems and Controls

Following our supervisory engagements in these credit unions, we found operational risk issues related to internal processes/systems and controls in 24 credit unions across the sample of 57 credit unions.

Common risk issues identified in this area included the following:

- ***Weaknesses in the maintenance of Business Continuity Plans (BCPs).*** *This included a lack of testing of BCPs, as well as examples of plans not being reviewed or updated following testing and not reflecting any adverse findings or shortcomings identified. This leads to the risk that the BCPs may not be adequate and services may be interrupted owing to an unexpected risk event occurring;*
- ***Weaknesses relating to segregation of duties.*** *This included failures to implement controls identified in policies on the segregation of duties; and*
- ***Weaknesses related to controls around club accounts***.

Information Technology

We found operational risk issues related to IT in 9 credit unions across the sample of 57 credit unions. The lower number of risk issues identified in this particular risk area for this asset classification, relative to the number identified in the 'credit unions with assets of at least €100m' asset classification is considered to be a reflection of the greater intensity of inspections, including Full Risk Assessments, undertaken in the larger credit unions:

- ***IT system/framework issues.*** *This included issues, identified during IT system testing, which were not subsequently resolved by the credit union, failure to fully integrate IT operational risks into the credit union's risk management system, both of which could expose the credit union to IT operational risk incidents and events; and*

- ***Evidence of inadequately resourced IT functions***.

It is concerning to note that a number of credit unions failed to address issues identified during IT system tests conducted by external IT professionals. Resolving these issues and, where necessary, updating related policies and procedures, is important to strengthen the credit union's IT system and framework.

Further information on risks identified relating to IT during Full Risk Assessments of larger credit unions, risks which are also relevant to credit unions with assets less than €100m are set out in section 7.4 below.

Bank and Cash Control Framework

Following our supervisory engagements in these credit unions, operational risk issues related to the bank and cash control framework were identified in 6 credit unions across the sample of 57 credit unions. As with IT risks above, the relatively low number of risk vulnerabilities identified for this asset classification is likely to have been impacted by the particular focus of the supervisory engagements undertaken.

Common risk issues identified in this area were the following:

- ***Weaknesses in documented procedures for bank and cash reconciliations****; and*
- ***Concerns regarding cash management and movement procedures.***

Credit unions in this asset classification should also consider the findings across the 'credit unions with assets of at least €100m' asset classification.

Anti-Money Laundering/Counter Terrorist Financing

Following our supervisory engagements, we found operational risk issues related to AML in 5 credit unions across the sample of 57 credit unions.

Common risk issues identified in this area included the following:

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

7.3. Operational Risk – Supervisory Expectations

Internal Processes/Systems and Controls

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

Bank and Cash Control Framework

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

Anti-Money Laundering/Counter Terrorist Financing

- Credit unions shall adopt policies, controls and procedures to prevent and detect the commission of money laundering and terrorist financing, as required by the Criminal Justice Act (Money Laundering and Terrorist Financing) Act 2010, as amended. This should include, but is not limited to, policies, controls and procedures dealing with customer due diligence measures, ongoing monitoring of customer profiles, and the reporting of suspicious transactions to the relevant authorities. The AML control framework in place should be appropriate for the size and scale of the credit union, and regular review and testing of the framework should conducted to ensure it is fit-for-purpose.

Information Technology

- Credit unions should have in place effective structures to manage IT related risks that are appropriate for the business model, size and technological complexity of the credit union, as well as the sensitivity and value of information and data assets held. It is important that the IT function is adequately resourced with responsible and accountable individuals. Further information of our supervisory expectations in relation to information technology are set out in section 7.4.

7.4. Overview of 2019 IT Inspections

Background

The rapid advancement of technology innovations in recent times has fundamentally changed business processes and models in financial firms of all sizes including credit unions. These advancements have introduced efficiencies and cost savings for firms and their customers. However, these technologies also bring significant risks, as firms become increasingly interconnected and more reliant on increasingly complex IT systems and outsourcing service providers to conduct their business and deliver services to members.

The risks associated with IT and cybersecurity are a key concern for the Central Bank given their potential to have serious implications for prudential soundness, consumer protection, financial stability and the reputation of the Irish financial system. Accordingly, the Central Bank expects that the boards and senior management of credit unions fully recognise their responsibilities in relation to IT and cybersecurity governance and risk management and place these among their top priorities. It is the board and management's responsibility to understand the specific IT related risks that the credit union faces and to ensure that these are sufficiently mitigated in line with the credit union's risk appetite. Credit unions need to understand their vulnerabilities in relation to risks associated with IT and cyber security and work to address these. This is of particular importance in an environment where an increasing proportion of services are provided remotely.

IT related risk management must be comprehensive and robust, addressing key risk areas such as business strategy alignment, outsourcing, change management, cybersecurity, disaster recovery and business continuity.

2019 IT Inspections

As part of our 2019 inspections programme we undertook a number of Full Risk Assessments in credit unions with assets of at least €100m. Supported by Central Bank IT risk specialist supervisors an element of these inspections focused on Information Technology risk.

These inspections focused on a range of areas including the following:

- IT strategy;
- IT governance;
- IT policies;
- IT risk management;

- Outsourcing;
- Business/service continuity;
- Cyber security; and
- Information security.

Inspections included interviews with key personnel including the IT officer, IT consultants and the Risk Officer and Compliance Officer, together with a review of documentation provided by the credit unions which included the strategic plan, risk register, risk management policy, risk reports, business continuity policy, outsourcing policy, IT policies, board minutes, SLAs with outsourced service providers and reports prepared by 3rd parties where relevant.

Key findings

The inspection team noted that some of the credit unions inspected demonstrated a good level of understanding of awareness of the risks associated with IT and Cyber. They also noted a number of positive IT risk management behaviours exhibited in some of the credit unions inspected. These included an inventory of appropriate IT policies and procedures, detailed IT asset register and business continuity plan, penetration testing, targeted phishing and social engineering testing, cybersecurity training for staff and a level of disaster recovery testing.

The inspection team also identified a number of IT risk issues during their inspections. The sections below set out key issues identified with an overview of key supervisory expectations in these areas. Further detailed information on the Central Bank's supervisory expectations in these areas is available in the following publications:

Cross Industry Guidance in respect of Information Technology and Cybersecurity Risks

IT Risk in Credit Unions - Thematic Review Findings

IT Strategy

The IT inspection team identified examples of credit unions that did not have a ***documented IT strategy***. It was also noted that in some cases the credit union's current business strategy did not include IT strategy at a level which would ensure that **IT and business strategy are aligned** over the medium to long term. It was also found that the documented IT strategy did not in all cases **include all key projects** under consideration by the credit union, demonstrating that the IT strategy had not been **regularly reviewed and updated**.

Supervisory Expectations

The board and management are responsible for setting and overseeing the credit union's business strategy and risk appetite and should ensure that IT risk is considered in this context. In addition, Senior Management is responsible for the effective implementation of the firm's business and IT strategies.

IT is a core enabler of the business with most if not all of the critical business functions supported by IT. As such, it is important that the IT strategy is comprehensive and aligned with the overall business strategy so that it can deliver on objectives to support the current and future strategic direction of the credit union. The firm's IT risk management framework should be comprehensive and is fundamental to facilitating an **effective assessment of the IT risks** to business operations as well as **improved decision-making** when dealing with risks that could affect critical business operations.

IT Risk Management & Reporting

The IT inspection team identified issues around the ***quality of IT risk management and reporting***. The team noted that some credit union **risk registers did not adequately reflect IT risks**, were not **reviewed and updated** in line with the credit union's own policies, or were **inconsistent** in the recording of IT risks with respect to the credit union's Risk Appetite Statement, reducing the ability of the credit union to effectively monitor and mitigate their IT risks. In some cases **controls were not documented** against identified IT risks, and in others, **no control testing or validation process** was in place to verify that mitigating controls are operating effectively. Weaknesses were also found in **organisational practices** with respect to business continuity/disaster recovery, IT asset inventory and IT security, including an **over-reliance on persons with IT knowledge**. Some findings also noted an **absence of business involvement** in the assessment or review of IT risks and controls.

Issues were also identified with the **quality of reporting on IT risks to boards** including examples of **failure to report** identified IT risks to the board, **ad-hoc/informal** IT reporting processes, and examples of **overly technical reports** being provided which did not support board awareness of IT issues and risks.

Supervisory Expectations

Credit unions are expected to develop, implement, maintain and communicate an appropriate IT risk management framework. The credit union's IT risk management framework should be comprehensive. **IT risk assessments should be conducted at regular intervals** taking account of internal and external sources of risk. A thorough **inventory of IT assets**, classified by business criticality, should be established and maintained.

An up-to-date **list of identified IT risks** should be developed and maintained, wherein the risks are prioritised and described in sufficient detail so as to be clearly understood, enabling their proactive management.

Adequate **management processes and plans for IT incident detection, notification and escalation** should be developed by credit unions. Appropriate recovery and resumption objectives should be developed to prepare for when incidents occur to reduce impact when they do, with prioritisation given to the recovery and resumption of critical functions.

The effectiveness of IT controls should be subject to **periodic independent review** and, where warranted given the nature and scale of the firm, **penetration testing** should be carried out. Such reviews are conducted by individuals with appropriate IT audit expertise and details of the key findings and associated implications should be provided to the board. Weaknesses identified in the control environment must be **remediated in a timely manner**.

IT Policies

The IT inspection team identified a number of issues related to governance structures to manage IT related risks including a number of issues relating to IT related policies. In some cases key IT policies had **not been documented** while in other cases existing policies **lacked sufficient detail** – this included examples of credit unions using **generic IT policy documents** that were insufficiently tailored to the credit union's specific circumstances. There were also examples of **failure to perform reviews and updates** to IT related policies on a sufficiently regular basis; and failures to perform substantive reviews of IT policies.

Supervisory Expectations

Documented policies, standards and procedures which address the identification, monitoring, mitigation and reporting of the firm's IT related risks should be in place. These should be regularly **reviewed and updated to reflect changes in the internal IT operating environment and the external security environment.**

The **roles and responsibilities** in managing IT risks, including in emergency or crisis decision-making, should be clearly **defined, documented and communicated** to relevant staff.

IT Security Management/Cybersecurity

The IT inspection team identified a number of issues around IT security management including examples of weakness in **user access management processes** and **poor IT security awareness** amongst credit union staff. The team identified examples where staff training could be enhanced particularly for new users. The team also noted that some credit unions had not put **cyber incident response plans** in place.

Supervisory Expectations

Credit unions are expected to have adequate processes in place to effectively address cyber risk.

At a minimum, cyber risk management should address:

- The identification of threats, vulnerabilities and risks and quantification of exposure specific to the credit union;
- The prevention and detection of security events and incidents, including reducing likelihood of occurrence and potential impact when it does;
- Security incident handling; and
- Recovery planning for stabilisation and continuity of operations in the immediate aftermath of a security incident.

Robust safeguards should be in place to protect against cybersecurity events and incidents. Techniques and technologies that credit unions may consider include, but are not limited to, strong authentication, encryption, intrusion prevention and detection, advanced malware protection, strong access controls (including physical controls) and network segmentation providing isolation and defence in depth when required.

Adequate processes should be in place to monitor information systems and assets and to detect security events and incidents in a timely manner, preferably using predictive indicators. The effectiveness of detection processes and procedures are **tested periodically**. This can be achieved by conducting penetration testing exercises undertaken by either the credit union's staff or third parties.

Cyber risk assessments should be performed on a regular basis and include identification of external and internal threats.

Poor security awareness in a credit union is a significant contributor to increased cyber risk. Awareness can be increased through **training programmes** to provide information on good IT security practices, common threat types and the credit union's policies and procedures regarding the appropriate use of applications, systems and network. It is important to note that

basic security practices such as keeping login details private and regularly changing passwords are just as important as more complex defence applications and systems.

Credit unions are expected to **notify the Central Bank when it becomes aware of a cybersecurity incident** that could have a significant and adverse effect on the credit union's ability to provide adequate services to its customers, its reputation or financial condition.

Outsourcing Management

The inspection team noted the large number of IT outsourced service providers (OSPs) used by some credit unions. These included OSPs for core banking services, IT networks and hardware and payments clearing. The inspection team identified a number of examples where credit unions did not have **full oversight of their key service providers** noting that **management of outsourcing as an IT risk was underdeveloped** with failures to document or monitor service levels for key service providers noted.

In addition, it was found that some credit union **IT policies lacked the detail and clear statements** necessary to enable an outsource partner to comply and meet the expectations of the credit union.

Supervisory Expectations

Credit unions should have a framework in place with **clear lines of responsibility** for ongoing management, operational oversight, risk management and regular review of the credit union's OSPs.

Thorough due diligence must be conducted on prospective OSPs. Due diligence includes consideration of, inter-alia, the OSP's technical capabilities, performance track record and financial strength and viability. The due diligence should also consider whether the OSP can meet its requirements in relation to service quality and reliability, security and business continuity in both normal and stressed circumstances. Credit unions should satisfy themselves that the selected OSP has sufficient and robust controls in place in relation to its cybersecurity. **These controls should be at least as strong as the controls utilised by the credit union itself.**

The contract between the firm and its selected OSP includes a **documented SLA or equivalent**. The SLA should:

- Clearly set out the nature, quality and scope of the service to be delivered as well as the roles and responsibilities of the contracting parties; and

- Include requirements for service levels, availability, and reliability, including measurable performance metrics and remedies for performance shortfalls. Using the key provisions of the SLA, firms regularly monitor the service delivery performance to determine if the OSP is delivering to the required standards. Where performance shortfalls are identified, these are addressed with the OSP in a timely manner; and include provisions relating to system and information/data security, business continuity and disaster recovery, service scalability, assurance and service termination, where appropriate. In particular, where new storage services are utilised, such as cloud, contracts with cloud providers specify the location(s) where credit unions should review the performance of OSPs against SLAs on a regular basis.

8. Strategy/Business Model Risk

Overall Supervisory Expectations

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

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

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

We outline specific supervisory expectations related to strategy/business model risk findings from our supervisory engagements in Section 8.3. While these reflect our supervisory expectations for credit unions in both asset classifications, we expect that credit unions should take account of the nature, scale and complexity of their own business in considering how these expectations can inform their approach to identifying, managing and mitigating strategy/business model risk issues in their credit union.

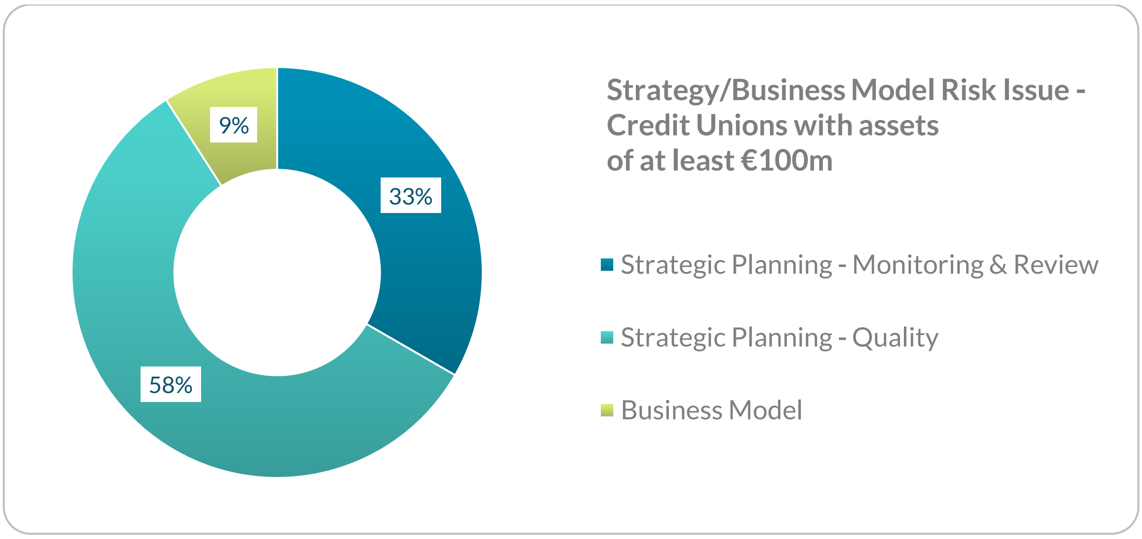
Overall Strategy/Business Model Risk Findings

Some of the overall weaknesses identified during the review period related to the quality of strategic planning. Examples of strategic plans lacking in appropriate detail were identified during supervisory engagements including failure to articulate clear timeframes and assign responsibilities for objectives. Supervisors also noted failures to review and update strategic plans.

In some cases, we observed viability concerns where it was apparent that the credit union would be unlikely to be able to generate a surplus in the short to medium term. In such instances we would expect to see those boards considering alternative strategies to serve their credit union's members' future needs, including the option of a transfer of engagements to a financially stronger credit union, capable of serving those needs of members into the future.

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

Of the 29 credit unions with assets of at least €100m that received an RMP during the review period, 21 credit unions were found to have strategy/business model risk issues. The key strategy/business model risk issues identified are in the areas of strategic planning - quality, strategic planning – monitoring & review and business model.



Strategic Planning – Quality

Following our supervisory engagements in these credit unions, we found strategy/business model risk issues related to quality of strategic plans in 15 credit unions across the sample of 29 credit unions.

Common risk issues identified in this area included the following:

- ***Examples of strategic plans lacking sufficient detail****, including absence of timeframes, measurement criteria or owners of objectives; and*
- ***Evidence of financial projections which were out of date*** *and/or not reflective of the stated objectives of the credit union.*

In order to improve the quality of the strategic planning process, there needs to be on-going dialogue between the board and management in respect of owners of objectives, level of detail and the appropriate measurement criteria required. This includes a shared understanding of the credit union's operating environment, associated risks and opportunities. The strategic plan should include an assessment of key financial and non-financial resources needed to support the activities undertaken or to be undertaken in the strategic plan, and the board should ensure that the credit union's information systems are appropriate to support the stated objectives.

Strategic Planning – Monitoring & Review

Following our supervisory engagements in these larger credit unions, we found strategy/business model risk issues related to the monitoring and review of strategic plans in 9 credit unions across the sample of 29 credit unions.

Common risk issues identified in this area included the following:

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

Business Model

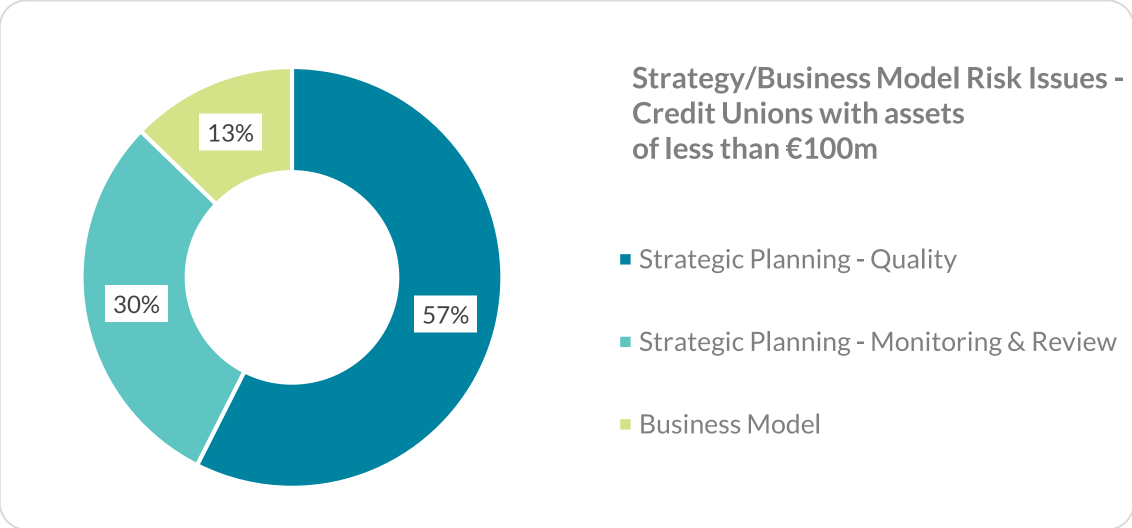
Following our supervisory engagements in these credit unions, we found strategy/business model risk issues related to the business model in 3 credit unions across the sample of 29 credit unions.

A common risk issue identified in this area was:

- ***Significant viability concerns*** *were noted in some cases across this sample. This included lower than average loan-to-asset ratios, lower than average return on assets and lower than average total realised reserves.*

8.2. Strategy/Business Model Risk – Credit Unions with assets less than €100m

Of the 57 credit unions with assets of less than €100m issued an RMP during the review period, 40 were found to have strategy/business model risk issues.



Strategic Planning – Quality

Following our supervisory engagements in credit unions in this classification, we found strategy/business model risk issues related to the quality of strategic plans in 23 credit unions across the sample of 57 credit unions.

Common risk issues identified in this area included the following:

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

Strategic Planning – Monitoring & Review

Following our supervisory engagements with these credit unions, we found strategy/business model risk issues related to the monitoring and review of strategic plans in 16 credit unions across the sample of 57 credit unions.

Common risk issues identified in this area included the following:

- ***Failure to monitor the performance of the credit union against the strategic plan** including failure to include adequate/appropriate key performance indicators to monitor achievement of objectives;*
- ***Failure to update the strategic plan** and /or incorporate the findings of any reviews of the plan; and*
- ***Lack of evidence of challenge from board** to management on the strategic plan.*

Business Model

Following our supervisory engagements in these credit unions, we found strategy/business model risk issues related to the business model in 6 credit unions across the sample of 57 credit unions.

Common risk issues identified in this area included the following:

- ***Evidence of significant viability concerns*** *were noted in some cases across this sample of credit unions, representing challenges and constraints to the business model of the credit unions; and*
- ***Absence of appropriately stress tested financial projections****, and a failure to monitor these financial projections.*

8.3. Strategy/Business Model Risk – Supervisory Expectations

Strategic Planning – Monitoring and Review

- Our expectation is that strategic management is viewed as an on-going activity by the board, not as a once-off task. In undertaking reviews and monitoring the strategic plan, the board needs to have a clear understanding of the credit union's performance, as well as its capabilities and capacity in order to inform such reviews.
- There should be demonstrable board oversight of strategy and associated implementation, including risk assessment and where required, effective risk mitigation arising from the implementation of same.

Strategic Planning – Quality

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

Business Model

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

9. Investment, Liquidity & Capital Risks

Overall Supervisory Expectations

Investment/Liquidity

Under section 43 of the Credit Union Act, 1997 (the 1997 Act), credit unions are required to ensure that they manage investments to ensure that they do not involve undue risk to members' savings and that before making an investment they assess the potential impact of the investment on the credit union, including the impact on the liquidity and financial position of the credit union.

Investment decisions must reflect appropriate levels of investment risk for credit unions consistent with the requirement under section 43 of the 1997 Act. Credit union investment decisions and investment portfolios should reflect the objects of credit unions[9] and the fact that it is the savings of credit union members (which can be withdrawn on demand) that are being invested by credit unions. Credit unions' investment risk appetite and the risk profile of investment portfolios should reflect this. While in the current low interest rate environment this will limit the potential to generate significant income from credit union investment portfolios, RCU is of the view that the overriding consideration in making investments must be the protection by credit unions of the funds of its member.

In ensuring that any investments made do not involve undue risk to members' savings, credit unions should ensure that detailed analysis and careful consideration is undertaken before making any investment decisions to ensure associated risks are fully understood and considered. Investments should be in line with the investment policy and stated risk appetite of the credit union and the rationale for investment decisions should be understood and documented.
Credit unions are required to:

- Develop, implement, document and maintain a risk management system with such governance arrangements and systems and controls to allow them identify, assess, measure, monitor, report and manage the risks which it is, or might reasonably be, exposed to; and
- Implement systems and controls to manage and mitigate the risks identified by the risk management system.

We expect investment decisions in credit unions to be supported by the risk management framework, with input from the risk management officer as appropriate.

[9] The primary objects and purpose of a credit union is the promotion of thrift among its members by the accumulation of their savings and the creation of sources of credit for their mutual benefit at fair and reasonable interest rates.

Capital

Adequate reserves are necessary to support a credit union's operations, provide a base for future growth and protect against the risk of unforeseen losses. Credit unions need to maintain sufficient reserves to ensure future sustainability and to protect members' savings. Adequate reserves are key to maintaining member confidence and on-going sector stability. Given the level and risk and uncertainty regarding the economic outlook the Central Bank expects credit unions to take a very conservative approach to reserve management.

The regulatory reserve requirement of 10 per cent of assets sets out the ***minimum reserve requirement*** for credit unions. However, credit unions are expected to operate with a level of reserves above the regulatory reserve minimum requirement. It is for the board of directors of each credit union to decide on the amount of reserves to hold in excess of this minimum requirement having taken prudent account of the scale and complexity of the credit union's business, its risk profile and prevailing market conditions.

Credit unions are also required to hold additional reserves in relation to operational risk. When determining the appropriate level of operational risk reserves to hold, credit unions should assess the level of operational risk they are exposed to. We expect that the amount the credit union holds in its operational risk reserve is based, at a minimum, on the predicted impact of operational risk events that may have a material impact on the credit union's business.

Overall Risk Findings

While the risk issues identified in relation to investment, liquidity and capital risks represented a relatively small proportion of findings in the sample of credit unions subject to review during the period, these are key areas for all credit unions to keep under review.

Common risk issues identified in these areas included weaknesses in liquidity and reserve management policies.

Supervisors also identified examples of shifts in the risk profile of investment portfolios without evidence of detailed consideration and discussion on these decisions at board level.

Data provided by individual credit unions via the Prudential Return and the Questionnaire issued in February 2019 highlights a number of liquidity/investment trends including a shift to longer dated investments and the introduction of a number of new investment counterparties.

Credit unions should ensure that detailed analysis and careful consideration is undertaken before making any investment decisions to ensure associated risks are fully understood and considered. Careful consideration should be given to any potential shift in the risk profile of a credit union's investment portfolio including an extension in the maturity profile or the introduction of new counterparties.

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