

# RESERVES

## Contents

|  |          |
|--|----------|
| <b>1. Legislation .....</b>              | <b>2</b> |
| <b>2. Regulations .....</b>              | <b>5</b> |
| <b>3. Guidance .....</b>                 | <b>7</b> |
| 3.1 Initial Reserve Requirement .....    | 7        |
| 3.2 Regulatory Reserve Requirement ..... | 8        |
| 3.3 Operational Risk Reserve .....       | 9        |
| 3.4 Reserve Management Policy .....      | 10       |
| 3.5 Reporting Requirements .....         | 11       |

## Version History

| Version | Date           | Amendments   |
|---------|----------------|--|
| 0.1     | July 2013      | Initial Version.   |
| 1.0     | September 2013 | No Amendments.   |
| 1.1     | November 2015  | <ul style="list-style-type: none"> <li>• Amended section 45 to reflect the commencement of section 13 of the 2012 Act.</li> <li>• Removed Credit Union Act, 1997 (Section 85) Rules 2009 (S.I. No. 334 of 2009).</li> <li>• Inserted regulations in Section 2.</li> <li>• Amended section 85(5) to reflect the commencement of item 76 of schedule 1 of the 2012 Act.</li> </ul> |
| 1.2     | January 2016   | Updated regulations in Section 2.  |
| 1.3     | September 2024 | Amended text in section 55(1)(o) of the 1997 Act to reflect the commencement of changes to section 55(1)(o) of the 1997 Act by the Credit Union (Amendment) Act 2023.  |

## 1. Legislation

### Section 45\*

(1) In this section —

'assets' means such assets as the Bank may from time to time specify for the purposes of this section;

'regulatory reserve' means a reserve that is a realised financial reserve which is—

- (a) unrestricted and non-distributable,
- (b) identified separately in a credit union's accounts, and
- (c) to be maintained by a credit union pursuant to this section;

'regulatory reserve requirement' means the amount required to be held in the regulatory reserve of a credit union, expressed as a percentage of the assets of a credit union and prescribed by the Bank.

(2) A credit union shall maintain reserves that are adequate having regard to the nature, scale, complexity and risk profile of its business.

(3) The Bank may prescribe the regulatory reserve requirement that a credit union shall maintain at a minimum and, in so prescribing, may include conditions on the application of the regulatory reserve requirement. For that purpose the Bank may also prescribe in respect of other matters related to the regulatory reserve requirement, including any of the following:

- (a) the application of risk weightings to assets for the purposes of calculating the regulatory reserve requirement;
- (b) the types and attributes of the assets or liabilities included in the calculation of the regulatory reserve requirement;
- (c) the requirement for initial reserves to be held by a newly-registered credit union under section 6.

(4) Where requirements to which subsection (3)(c) relate have been prescribed, they shall not apply to a credit union established as a result of amalgamations of 2 or more existing credit unions.

- (5) A credit union shall maintain reserves, in addition to the regulatory reserve requirement prescribed under subsection (3) that—
- (a) it has assessed are required in respect of operational risk having regard to the nature, scale, complexity and risk profile of its business, and
  - (b) which shall not be less than those required under any additional reserve requirement applicable to it in respect of operational risk by virtue of subsection (6).
- (6) Either or both the level of additional reserves to be maintained by a credit union and the basis for calculating the additional reserves to be maintained by a credit union under this section in respect of operational risk may be prescribed by the Bank. For that purpose the Bank may also prescribe in respect of ancillary matters related to the additional reserves held in respect of operational risks.
- (7) A credit union that fails to meet any reserve requirement under this section—
- (a) may be required by the Bank to transfer all or part of its surplus to reserves, and
  - (b) shall secure the written approval of the Bank before paying a dividend or loan interest rebate.
- (8) In prescribing matters for the purposes of this section, the Bank shall have regard to the need to ensure that the requirements imposed by the regulations made by it are effective and proportionate having regard to the nature, scale and complexity of credit unions, or of the category or categories of credit unions, to which the regulations will apply.
- (9) (a) Pending the prescribing by the Bank of reserve requirements for the purposes of this section in respect of credit unions generally or a category of credit unions, the reserve requirements applicable to credit unions under section 85 shall continue to apply generally or to such category of credit unions, as the case may be.
- (b) Where reserve requirements have been prescribed by the Bank for the purposes of this section in respect of credit unions generally or a category of credit unions, then section 85 shall cease to apply generally to that category of credit unions, as the case may be, in respect of the matters so prescribed.

**Section 85 – Assets and liabilities ratios and structures**

*(This Chapter has not reproduced the entirety of section 85 – please consult the Credit Union Act, 1997 for the full provision.)*

...

(3) The Bank may from time to time by notice in writing require a credit union to maintain, between its assets and its liabilities—

- (a) a ratio specified in the requirement,
- (b) a ratio which does not exceed a ratio so specified, or
- (c) a ratio which is not less than a ratio so specified,

and a ratio may be so specified as a percentage of the assets or liabilities concerned.

(4) A requirement of the Bank under *subsection (3)* may be expressed to apply in one or, more of the following ways—

- (a) in relation to all credit unions or to credit unions of a category or categories specified in the requirement;
- (b) in relation to the total assets or total liabilities of the credit unions concerned or in relation to such assets or kinds of assets or such liabilities or kinds of liabilities as may be specified in the requirement;
- (c) in relation to such time or times or during such period or periods as may be so specified.

(5) ≠ The Bank may, from time to time, by notice in writing specify, as respects a credit union, requirements as to the composition of its assets or, subject to regulations made under section 27(2), the composition of its liabilities.

(6) In this section—

- (a) "liabilities" include such contingent liabilities as the Bank may from time to time specify by notice in writing for the purposes of this section; and
- (b) "liquid assets" mean such assets as the Bank may from time to time specify by

notice in writing for the purposes of this section;

and, until the Bank specifies assets as mentioned in *paragraph (b)*, "liquid assets" include assets held in a form provided for by *section 43*.

(7) Where, under the preceding provisions of this section, the Bank by notice in writing imposes a requirement or specifies any matter, and the requirement is to apply or the matter is specified otherwise than in relation to a particular credit union, the power to give the notice shall be exercisable by rules.

### **Section 55 – Functions of board of directors\***

*(This Chapter has not reproduced the entirety of section 55 – please consult the Credit Union Act, 1997 for the full provision.)*

(1) Without prejudice to the generality of section 53(1), the functions of the board of directors of a credit union shall include the following:

...

(o) approving, reviewing, and updating, where necessary, but at least every 3 years, all plans and policies of the credit union, including the following:

...

(iv) reserve management policies;

...

## **2. Regulations**

### **CREDIT UNION ACT 1997 (REGULATORY REQUIREMENTS) REGULATIONS 2016**

**(S.I. No. 1 of 2016)**

*(This Chapter has not reproduced the entirety of Part 1 – please consult the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 for the full provision.)*

#### **PART 1**

#### **PRELIMINARY AND GENERAL**

#### **Interpretation**

In these Regulations, unless the context otherwise requires:-

“assets” means all of the assets referred to in section 85A of the Act;

“the Bank” means the Central Bank of Ireland;

“the Act” means the Credit Union Act, 1997;

## **PART 2**

### **RESERVES**

#### **Reserves Perpetual in Nature and Available to Absorb Losses**

3. (1) A credit union shall ensure that all reserves held in accordance with, and for the purpose of, this Part and section 45 of the Act are:
  - (a) perpetual in nature;
  - (b) freely available to absorb losses;
  - (c) realised financial reserves that are:
    - (i) unrestricted; and
    - (ii) non-distributable.
- (2) For the purpose of paragraph (1), any instrument classified or contributing to a reserve shall, in order to be eligible:
  - (a) not be secured or subject to a guarantee which enhances its seniority;
  - (b) be permanent and without an obligation for repayment of principal;
  - (c) have no preferential distribution rights;
  - (d) rank below all other claims in the event of a liquidation;
  - (e) qualify as a reserve for accounting purposes.

#### **Regulatory Reserve Requirement**

4. (1) Subject to paragraph (2), a credit union shall establish and maintain a minimum regulatory reserve requirement of at least 10 per cent of the assets

of the credit union.

- (2) A newly registered credit union shall establish and maintain an initial reserve requirement that:
  - (a) is sufficient to meet the credit union's anticipated growth over 3 years;
  - (b) takes account of operating losses that can be expected to occur until the credit union reaches an operationally viable performance level; and
  - (c) is at least equal to the greater of:
    - (i) €10,000; or
    - (ii) minimum regulatory reserve requirement specified in paragraph (1).

### **Reporting Requirements**

5. (1) A credit union shall monitor its reserves on a continuous basis to ensure compliance with this Part and section 45 of the Act.
- (2) Where a credit union fails, or is likely to fail, to comply with its reserve requirement in this Part or section 45 of the Act, the credit union shall notify the Bank in writing no later than close of business of the next business day.

### **Dividends**

6. Where a credit union has complied with the requirements in this Part and section 45 of the Act, but has recorded a deficit in its annual accounts and is proposing to pay a dividend and/or a loan interest rebate, the credit union shall inform the Bank in writing at least 3 weeks before it gives notice of its Annual General Meeting, as required under section 80(3) of the Act.

## **3. Guidance**

### **3.1 Initial Reserve Requirement**

A newly registered credit union will have zero or close to no assets. As the regulatory reserve requirement is calculated as a percentage of total assets, a newly established credit union could have a regulatory reserve requirement of zero or close to zero. An

initial reserve requirement is necessary to ensure that a newly registered credit union has adequate reserves to meet the credit union's anticipated growth and to take account of operating losses that can be expected to occur until the credit union reaches an operationally viable performance level. Until such time as a new credit union's regulatory reserve requirement exceeds €10,000 they are required to hold an initial reserve of €10,000.

The amount a newly registered credit union is required to hold in initial reserves will be determined on a case by case basis taking account of factors including the proposed business model, common bond, financial information and projections and the credit union's strategic plan. The minimum amount that a newly registered credit union will be required to hold in initial reserves is €10,000.

The initial reserve requirement is not additional to the regulatory reserve requirement. Reserves held for the regulatory reserve requirement also qualify as reserves for the purposes of the initial reserve requirement. When a credit union's regulatory reserve requirement equals or exceeds the initial reserve requirement the requirement to hold an initial reserve will fall away.

### **3.2 Regulatory Reserve Requirement**

Adequate reserves 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 continuity and to protect members' savings.

Regulatory reserves are required to meet the definition of reserves, set out in section 45 of the 1997 Act, as inserted by section 13 of the 2012 Act and to have the characteristics set out in regulation 3 of the Regulations. Commencement of section 13 of the 2012 Act, has removed any reference to the requirement for credit unions to hold a statutory reserve from the 1997 Act.

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

Notwithstanding that credit unions are no longer required to maintain a statutory reserve, credit unions are expected to continue to allocate surplus funds to maintain

reserves at an appropriate level having taken prudent account of the scale and complexity of the credit union's business, its risk profile and prevailing market conditions.

The Central Bank expects that credit unions whose total regulatory reserves are currently in excess of 10 per cent of total assets will continue to maintain reserves at existing levels on the basis that these continue to reflect the board of directors' assessment of the appropriate level of reserves for the credit union.

### **3.3 Operational Risk Reserve**

Credit unions are required to hold reserves in relation to operational risk. The reserves that credit unions hold against operational risk are separate, distinct and in addition to the reserves that the credit union is required to hold under the regulatory reserve requirement. All reserves that are held as operational risk reserves must have the characteristics, set out in regulation 3 of the Regulations.

Where operational risks are identified in a credit union the credit union's priority should be the mitigation of these risks through the implementation of appropriate processes and controls. The existence of an operational risk reserve does not impact on the need to appropriately mitigate operational risks.

When determining the appropriate level of operational risk reserves for a credit union, credit unions should assess the level of operational risk they are exposed to. The Central Bank expects that the amount the credit union is to hold in its operational risk reserve would be based, at a minimum, on the predicted impact of operational risk events that may have a material impact on the credit union's business. This will be impacted by the business mix and risk profile of the activities being undertaken in the credit union. This assessment may be supported by considering available information including:

- operational risks identified by internal processes:
  - operational risks to which the credit union is exposed, as identified by the Risk Management Officer and risk management system including operational risks recorded on the credit union's risk register;
  - reports of the internal auditor;
  - reports of the compliance officer;
  - the Annual Compliance Statement; and
  - previous operational risk events including inadequate or failed internal processes or systems of the credit union;
- operational risks identified in external reports:
  - reports from external consultants;
  - external auditor management letter issues;

- relevant asset review findings; and
- reports from whistle-blowers;
- other operational risk considerations:
  - implementation of the credit union's operational risk management system including the effectiveness of the credit union's internal control systems; and
  - external events.

Existing reserves in excess of 10 per cent of total assets may be allocated to the operational risk reserve where the board of directors have determined that it is appropriate to do so having taken account of the appropriate level of reserves for the credit union, taking prudent account of the scale and complexity of the credit union's business, its risk profile and prevailing market conditions.

### **3.4 Reserve Management Policy**

The reserve management policy should cover the following at a minimum:

- objectives of the policy;
- organisational arrangements setting out the roles and responsibilities of officers involved in reserve management;
- strategy setting out the quantity and quality of reserves to be maintained by the credit union over time, including the setting of reserve targets, to protect the credit union against unexpected losses taking account of:
  - the regulatory reserve requirement to be maintained by the credit union in compliance with the 1997 Act, the 2012 Act, the Regulations and any regulations made thereunder;
  - the risk profile of the credit union including the level of credit, market and operational risk in the credit union;
  - the risk tolerance of the credit union;
  - any reserve buffers the credit union requires such as a reserve conservation buffer;<sup>1</sup>
  - additional reserves required to support the strategic plan of the credit union; and
  - the current economic climate and business operating environment;
- plans for the generation of any additional reserves required to support the above;
- dividend and loan interest rebate policy;
- procedures for:
  - complying with minimum legal and regulatory requirements and guidance in relation to reserves;
  - monitoring, reviewing and reporting on the credit union's reserves position against reserves targets; and

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<sup>1</sup> A reserve conservation buffer is a buffer that is designed to build up reserves outside periods of stress and can be drawn down as losses are incurred.

**Reserves****Publication date: September 2024**

- regular stress testing of reserves and scenario analysis taking account of potential risks;
- contingency plans to be put in place if reserve targets are not met, including:
  - actions to be taken to protect the credit union's reserves position such as changes to dividend and loan interest rebate policy;
  - raising of additional reserves, if necessary; and
  - notifying the Central Bank where reserves fall below the regulatory minimum;
- reporting arrangements, including the frequency, form and content of reporting on the adequacy of reserves to the board of directors; and
- the process and timelines for the approval, review and update of the reserve management policy by the board of directors.

Credit unions should ensure that any significant deviations from the reserve management policy, the reasons for these deviations and proposed action to address the deviations are communicated to the board of directors in accordance with the reporting arrangements set out in the reserve management policy.

### **3.5 Reporting Requirements**

Where a credit union is notifying the Central Bank that it is failing, or likely to fail to comply, with the reserve requirement under the Regulations or section 45 of the 1997 Act the credit union should set out the steps it proposes to take to restore the reserve requirement and indicate the timeframe in which the reserve requirement will return to compliance.