ICURN

INTERNATIONAL CREDIT UNION REGULATORS' NETWORK

Guiding Principles

EFFECTIVE SUPERVISION OF FINANCIAL COOPERATIVE INSTITUTIONS

These 23 Guiding Principles (GPs) are recommended by the International Credit Union Regulators' Network (ICURN) as a framework for assessing the effectiveness of the supervisor of credit unions (however described), where the supervisor has statutory responsibility for their safety and soundness. They should be read in conjunction with the accompanying Guidance Notes.

The GPs form four Pillars, all of which must function adequately before a supervisor's activities may be considered to be "effective" overall.

Pillar I	Pillar II	Pillar III	Pillar IV
Registration and licensing of credit unions	Credit union structures and organisation	Prudential requirements	Supervisory Powers, Responsibilities & Approach
GPs 1 to 3	GPs 4 to 11	GPs 12 to 17	GPs 18 to 23

The Basel Committee on Banking Supervision's "Core Principles for Effective Banking Supervision" provide an internationally-accepted, well established, framework for assessing supervisors of international, national or regional/state banks, but they do not address certain of the unique characteristics that distinguish credit unions from other types of deposit-taker. The reader will note similarities between the Basel Guiding Principles and the ICURN Guiding Principles, which may facilitate comparisons between banks and credit unions, where this is useful. ICURN also hopes that these GPs will provide helpful guidance for credit union supervisors in jurisdictions where their powers are based on a system of self-regulation or other non-statutory arrangement.

The reader may find it helpful to read the relevant GPs in conjunction with the ICURN ***Guiding Principles for Enhancing Governance of Cooperative Financial Institutions***.

DEFINITIONS

In these GPs:

Credit union means a credit union, co-operative, or financial mutual that accepts deposits from its members, (including, for example but not exclusively, caisses populaires and deposit-taking SACCOs) that has been registered and licensed (or authorised) as such in its county/region/state of operation and which is subject to the jurisdiction of a supervisor;

Supervisor means the authority in a country/region/state with statutory responsibility for the safety and soundness of credit unions.

REGISTRATION AND LICENSING OF CREDIT UNIONS

Guiding Principle 1: REGISTRATION, LICENSING or AUTHORISATION

Credit unions should be established by reference to distinct legal characteristics, which should be applied when registering and licensing (authorising) new credit unions. At a minimum, the registration and licensing processes, as appropriate, should consider: ownership (which must be a co-operative or mutual structure); governance; fitness and propriety, capability and competence, of Board members and senior management; strategy; risk management and capital. This is not intended to be an exhaustive list and the relevant authorities should consider any additional criteria needed to facilitate effective supervision in their regimes. Where a country/region/state provides a deposit-protection scheme, registration and licensing must be requirement of a credit union's membership of the scheme.

Guiding Principle 2: OWNERSHIP

The structure of any proposed credit union must comply fully with internationally-recognised cooperative/mutual principles, taking account of circumstances where second-tier organizations have proportional voting for members. No individual or group of individuals may be permitted to exercise control from a minority position. Voting in credit union support organizations or associations may be proportional or representational.

Guiding Principle 3: PERMISSIBLE ACTIVITIES

The permissible activities of credit unions should be clearly defined, and the local terminology used to describe the entities undertaking these activities, such as *credit union, financial mutual, caisse populaire* and *SACCO*, should be restricted and controlled. There should be a power to enforce against the use of the restricted terminology by unlicensed entities. Business powers and permissible activities may be proportional to the credit union's size and ability to manage the risks inherent in such services and compatible with its business objectives.

CREDIT UNION STRUCTURES AND ORGANISATION

Guiding Principle 4: RISK MANAGEMENT

Credit unions should have, and use, appropriate risk-management processes and systems. A risk management system should be able to identify, evaluate, monitor, manage and control the risks to which the credit union may be exposed including, but not limited to, the specific risks described in this section. Policies and limits for risk undertakings should be clearly established and periodically reviewed. The risk management system should be commensurate with the size and complexity of the credit union and its activities. Credit union Board members should be provided with regular, accurate, management information and be capable (as a group) of interpreting that information and of challenging senior management on the application of the credit union's strategy.

Guiding Principle 5: MANAGEMENT OF OPERATIONAL RISK

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

Guiding Principle 6: MANAGEMENT OF CURRENCY RISK

Credit unions which are permitted to invest in deposits or securities that are denominated in the currency of another state should have a clear risk appetite and specific policies and practices designed to monitor and manage currency risk.

Guiding Principle 7: MANAGEMENT OF INTEREST RATE RISK AND MARKET RISK

Credit unions should have policies and processes in place to manage any interest rate risk to which they may be exposed. In particular, they should be attuned to the interest rate risk of fixed rate lending portfolios.

Guiding Principle 8: MANAGEMENT OF MARKET CONDUCT RISK

Where credit unions in a jurisdiction are permitted to engage in business that may expose them to market conduct risk they should have in place risk management policies and processes to identify, assess, monitor and control, and mitigate such risk. These policies and processes must be commensurate with the size and complexity of the credit union and its activities.

Guiding Principle 9: INTERNAL CONTROLS

Credit unions should have in place an appropriate level of internal controls commensurate with the size and complexity of the credit union and its activities. This should include arrangements around delegations of responsibilities, authorizations, segregation of duties, reconciliations and accounting for assets and liabilities.

Guiding Principle 10: ABUSE OF FINANCIAL SERVICES

Credit unions should have policies and procedures in place that will prevent them from being used for criminal activities, including money laundering. This should include having "know-your-customer" rules.

Guiding Principle 11: ACCOUNTING AND DISCLOSURE

Credit unions should maintain adequate records that have been prepared in accordance with the relevant accounting laws in its jurisdiction. Credit unions' records must be independently professionally audited and the full annual report prepared in accordance with the relevant accounting standards must be freely available to all members.

PRUDENTIAL REQUIREMENTS

Guiding Principle 12: CAPITAL ADEQUACY

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

Guiding Principle 13: LIQUIDITY AND FUNDING RISK

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

Guiding Principle 14: CREDIT RISK

The supervisor should ensure that credit unions have policies and systems that are designed to provide satisfactory management of its loan portfolio and the risks to which they are exposed. It is essential that a credit union is able to manage its credit portfolio effectively, monitors the performance of the portfolio and pursues loans in default. The supervisor should also ensure that credit unions engage only in types of lending that their Boards understand and are capable of managing effectively, while avoiding areas that require expertise they do not possess.

Guiding Principle 15: PROBLEM ASSETS, PROVISIONS AND RESERVES

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

Guiding Principle 16: LARGE EXPOSURES

The supervisor should set rules that define and limit the large exposures to which credit unions can be exposed and must have the power to intervene should these be breached. Credit unions must have appropriate and adequate policies and processes concerning large exposures (concentration risk).

Guiding Principle 17: MAJOR ACQUISITIONS

The supervisor should have the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and to impose prudential conditions on, major acquisitions or investments by a credit union, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the credit union to undue risks or hinder effective supervision.

SUPERVISORY POWERS, RESPONSIBILITIES AND APPROACH

Guiding Principle 18: SUPERVISORY POWERS & RESPONSIBILITIES

The supervisor should have:

- clearly-defined responsibilities and objectives;
- operational independence, transparent processes, sound governance, adequate resources and legal protection for its staff;
- all financial, human and technological resources necessary fully to discharge its responsibilities;
- complete and unfettered access to credit unions, their premises and records, (and any subsidiaries) as it considers necessary;
- the power and the resources to guarantee access to credit unions where this is not provided, and
- the legal capacity to share information while protecting the confidentiality of such information.

The supervisor should be publicly accountable in the discharge of its duties.

Guiding Principle 19: SUPERVISORY APPROACH, TECHNIQUES AND RESOURCES

The supervisor should develop and maintain a thorough understanding of the operations of individual credit unions, the risks to which they are exposed and the management of such risks, and must deploy an effective and ongoing combination of offsite and onsite supervisory techniques. Where the supervisor does not have the responsibility for oversight of a credit union's compliance with its licence conditions, for the prevention of criminal activities including money laundering, or other obligations covered by these GPs, it must have the power to refer its concerns to the appropriate authority and memoranda of understanding must be agreed and maintained accordingly.

Guiding Principle 20: SUPERVISORY REPORTING

The supervisor should have the resources and ability to collect financial and statistical reports from credit unions in whatever form it requires. It must also have the ability to have such reports or forms independently verified where it considers this necessary. The supervisor should undertake appropriate reviews and analysis of all such material and to take relevant action where this is indicated.

Guiding Principle 21: CONFLICTS OF INTEREST & RELATED-PARTY EXPOSURES

The supervisor should have the power to establish rules to control conflicts of interest and related-party exposures and it must have powers that permit it to intervene where such rules are breached. Rules must require that related-party transactions be undertaken at arm's length and there must be rules requiring full disclosure and reporting of such transactions.

Guiding Principle 22: INTERNAL AUDIT

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

Guiding Principle 23: CORRECTIVE AND REMEDIAL POWERS

The supervisor should have an adequate range of enforcement tools to facilitate timely corrective action, including the power and resources to issue appropriate legal orders, to revoke licenses, force liquidation, removal of officer or board members or to recommend revocation. This includes the power and resources to impose restrictions on a credit union's activities and operations.

GUIDANCE NOTES

This document replaces ICURN's publication of 16 September 2011. It retains most of the underlying philosophy and concepts of the original and ICURN gratefully acknowledges the work of its authors and the guidance gained from reference to the Core Principles for Effective Banking Supervision issued by the Basel Committee of Banking Supervision[1]. ICURN emphasises that this document has not been developed or endorsed by the Basel Committee, rather it has been prepared independently on behalf of ICURN's Board as guidance for members in assisting them in establishing and supporting effective systems of prudential supervision. ICURN's members operate in jurisdictions in a large number of states in six continents, with the diversity and unique local circumstances that this implies. For that reason, this guidance is offered as a "high-level" approach to considering specific supervisory systems, composed as they may be of unitary authorities or those where responsibilities are separated or shared between authorities. Equally, the legislative basis for the establishment of a credit union or other financial cooperative is often not within the remit of the authorities responsible for overseeing those institutions and this fact may mean that supervisors do not have all of the regulatory powers that they would wish or which ICURN regards as essential to the existence of an effective system of supervision.

ICURN's view is that the fundamental requirements for an effective system of supervision are:

- an effective legal framework, including the powers for licensing, authorisation, supervision, the enforcement of compliance with relevant laws and regulations;
- a clearly-defined and enforced safety-and-soundness regime;
- each supervisor involved in the supervision of the sector has clearly-defined responsibilities and objectives;
- each supervisor should have operational independence, transparent processes, sound governance and adequate resources, and legal protection for its staff;
- a supervisor should have the legal capacity to share information while protecting the confidentiality of such information, and
- a supervisor should be publicly accountable in the discharge of its duties.

The ICURN Steering Committee hopes that this document will allow supervisors to review their own effectiveness and to identify not only areas where valuable changes or improvements might be made but also any aspects of their work where their effectiveness is constrained for reasons not within their control. It may also form the basis of an independent review of a supervisor's effectiveness in certain circumstances. Where a credit union sector is mature and material to its local economy an independent review may call for a more detailed methodology and a tailored approach; in such circumstances ICURN would be happy to discuss specific circumstances and requirements with a view to preparing a review framework designed specifically to meet the supervisor's, or the state's, requirements.

[1] The Table attached to these Notes shows how the Guiding Principles correspond to the Basel Core Principles.

TABLE OF EQUIVALENCE BETWEEN *the* ICURN GUIDING PRINCIPLES FOR EFFECTIVE SUPERVISION *and* THE BASEL CORE PRINCIPLES

The reader is asked to note that the general differences between banks and co-operative financial institutions mean that not all Principles correspond directly.

Basel Core Principle	ICURN Guiding Principle
CP 1 Responsibilities, objectives and powers	GP 18
CP 2 Independence, accountability, resourcing and legal protection for supervisors	GP 18
CP 3 Cooperation and collaboration	GP 18; GP 19
CP 4 Permissible activities	GP 3
CP 5 Licensing criteria	GP 1
CP 6 Transfer of significant ownership	GP 2
CP 7 Major acquisitions	GP 17
CP 8 Supervisory approach	GP 19
CP 9 Supervisory techniques and tools	GP 19
CP 10 Supervisory reporting	GP 20
CP 11 Corrective and sanctioning powers of supervisors	GP 23
CP 12 Consolidated supervision	Not applicable
CP 13 Home-host relationships	Not applicable
CP 14 Corporate governance	GP 2; GP 4; GP 9
CP 15 Risk management process	GP 4
CP 16 Capital adequacy	GP 12
CP 17 Credit risk	GP 14
CP 18 Problem assets, provisions and reserves	GP 15
CP 19 Concentration risk and large exposure limits	GP 16
CP 20 Transactions with related parties	GP 21
CP 21 Country and transfer risks	Not applicable
CP 22 Market risks	GP 7
CP 23 Interest rate risk in the banking book	GP 7
CP 24 Liquidity risk	GP 13
CP 25 Operational risk	GP 5
CP 26 Internal control and audit	GP 9; GP 22
CP 27 Financial reporting and external audit	GP 11
CP 28 Disclosure and transparency	GP 11
CP 29 Abuse of financial services	GP 10

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The International Credit Union Regulators' Network (www.icurn.org) is an independent not-for-profit association of financial cooperative supervisors from around the world. ICURN provides supervisors with training, research and networking opportunities and is governed by a board of directors comprised of its members.