



## Registration of Existing Credit Unions with a Regulatory Authority December 30, 2002

In many countries, credit unions were originally chartered and registered under general cooperative laws as were cooperatives of all types. Over time credit unions have expanded the instruments they use for attracting funds and have become true savings and loan organizations, offering their clients similar savings choices to those found in more formal financial institutions. Because of these changes and enhancements to member service, credit unions should be licensed by an agency or body that is dedicated solely to financial institutions and the credit unions should be regulated and supervised in a similar fashion as other formal financial institutions are.

**Changes at the Supervisory Authority Level** – Where credit unions are to be formally regulated, the responsibility is normally given to the existing banking regulatory agency assuming:

- it has displayed reasonable competency in supervising banking institutions;
- the examiners chosen to provide credit union supervision will be adequately trained in credit union operations and supervision techniques; and
- credit unions would receive the supervisory attention needed even though they are smaller in asset size and therefore pose less systemic risk than banks.

Keeping banking and credit union supervision together in one institution facilitates a consistent regulatory approach to and treatment of different types of supervised financial institutions. It may at the same time be efficient and in the best interest of the credit unions to create a specialized credit union department within the overall regulatory agency. Credit unions have a unique ownership and governance structure and other special characteristics that set them apart from other financial institutions.

**Changes to Existing Legislation or Regulation** – In order to designate a regulatory authority as the regulator and supervisor of certain qualifying credit unions, the existing law or regulation usually will have to be changed. In making changes to the existing regulatory framework, or drafting new legislation and regulation, the following issues should be considered:

- Clear designation of those institutions that will be regulated;
- Establishment of the requirements to be met in order to receive a license to operate as an open credit union;
- The strengthening of credit unions both financially and operationally; and
- Establishment of whom will regulate the institutions and how they will be regulated.

In order to achieve the aforementioned, the new legislation or regulations should:

- Most importantly, establish a capital adequacy requirement that should be met prior to applying for a license from the regulatory authority and outline how this capital requirement is to be met. The capital requirement is best expressed as a percentage of assets. The regulation might establish only one capital requirement or establish

scaled institutional capital requirements based on the risk associated with the products and services offered by the credit union. The amount of required institutional capital should be sufficient to ensure that the credit union has the resources it needs to operate in an efficient manner given the services it offers, its expected volume of business, the associated operating and infrastructure costs, and working capital needs.

- Designate ownership shares as non-leverageable equity, not institutional capital, and establish limits on withdrawal.
- Require that all credit unions, prior to applying for licensing, have fully funded their allowances for investment, loan, and other asset losses for all potential losses.
- Establish minimum liquidity standards to diminish the possibility of the credit union not being able to meet member savings withdrawal requests.
- Limit the investment that can be made in fixed or non-earning assets.
- Require that standardized accounting be used to provide for transparent reporting.
- Require an external audit be performed, prior to applying for a license, and stipulate that the credit union should receive an unqualified or “clean” opinion to be considered for licensing.
- Establish minimum education and professional requirements for all officials and the general manager.
- Establish strict conflict of interest and insider dealing regulations that state what constitutes a conflict of interest and limits activities and dealing of officials and management to those that are beyond reproach or question.
- Allow credit unions to merge in order to meet the qualifications for licensing as an open credit union.
- Allow the regulatory authority:
  - to draft model bylaws that will assist credit unions in adapting their bylaws quickly and with the least margin of error; or
  - to require changes to existing bylaws, policies and procedures within credit unions registering for an open credit union license.
- Grant the regulatory authority the necessary powers to effectively supervise, regulate, and compel institutions to comply with any sanctions or administrative actions issued.

If, after changes in the regulatory framework are completed, there is more than one body regulating credit unions, emphasis should be placed on ensuring that the different supervising and/or chartering bodies work in harmony as much as possible when drafting and enforcing regulations and monitoring management and credit union operations.

**Required Documentation for Chartering** – Required documentation for a licensing application will vary from country to country, however, the following written documentation should be requested:

- Completed application for licensing as provided by the regulatory body that usually includes the following information:
  - the name and location of the credit union;
  - the field of membership;
  - the total amount of institutional capital;
  - the total amount of ownership shares;

- the names, positions, and number of officials that make up the board, credit and supervisory committees; and
- the products and services offered, including a breakdown of the loan portfolio as to collateral type and loan purpose that should also include the total loan amount and number of loans for each collateral type and loan purpose.
- Proposed bylaws that contain any required changes or adaptations as prescribed by the regulator;
- Resumes or educational and employment information for the members of the board, credit and supervisory committees, and the general manager;
- Organizational chart detailing the positions within the credit union and the individuals that fill the positions;
- Credit, collections, capital accumulation, investment, and personnel policies; and
- A 2-3 year business plan.

**Meeting Requirements of the New Regulatory Framework** – Non-regulated institutions can not be expected to comply immediately with all aspects of the law, bylaws, and rules and regulations. Because the supervisory authority generally has much more stringent requirements than the original cooperative chartering agency, the open credit unions should be given adequate time to comply with the new requirements and standards to allow for changes in operations, financial structure, procedures, policies and accounting. This process of bringing credit unions into line with the regulatory framework so they can engage in financial intermediation has four stages.

- **Stage One** – Information and instructions should be given to the credit unions to assist the officials, members, and daily management in deciding whether to operate as an open or closed credit union. The information should include the necessary documentation to be submitted, the qualifications that must be met in order to be registered as an open credit union, and the time frame in which the institutions have to comply. Credit unions should be required to declare in writing, to the appropriate authorities, if they intend to function as an open or closed institution
- **Stage Two** – Involves the receipt and evaluation of the information provided by those credit unions applying to be registered as open credit unions. Upon evaluating all of the requests, the regulator should prioritize the eligible institutions that have met all the requirements by asset size, membership size, degree of financial intermediation with a broader-based community oriented group, and overall institutional risk.
- **Stage Three** - Upon prioritizing the credit unions as previously mentioned, the regulator should perform an on-site examination to evaluate the safety, soundness, and institutional preparedness for the licensing change. The objectives of this examination are similar to that of an annual examination:
  - evaluate the credit union's financial soundness;
  - appraise the quality of management;
  - develop plans with officials to correct problems; and
  - determine the degree of risk to the credit union system as a whole and to the insurance fund, if applicable.

- **Stage Four** – If the credit union meets all of the requirements for licensing under the regulatory authority then the license should be granted and the credit union subject to regulation just as any other formal financial institution.

**© 2003 World Council of Credit Unions**

5710 Mineral Point Road, PO Box 2982, Madison, Wisconsin 53705-4493, USA

**Phone:** (608) 231-7130 **Fax:** (608) 238-8020 **Email:** DevBestPractices@woccu.org **Website:** www.woccu.org