Guiding Principles

International Credit Union Regulators' Network (ICURN)

Effective Prudential Supervision of Cooperative Financial Institutions

The Guiding Principles incorporate 21 principles recommended by the International Credit Union Regulators' Network (ICURN) for effective supervision of cooperative financial institutions. The principles are categorized into six groups:

GROUP 1 – **Objective, Independence, Powers, Transparency and Cooperation**
GROUP 2 – **Licensing and Ownership**
GROUP 3 – **Prudential Regulation and Requirements**
GROUP 4 – **Methods of Ongoing Supervision**
GROUP 5 – **Accounting and Disclosure**
GROUP 6 – **Enforcement**

OBJECTIVE, INDEPENDENCE, POWERS, TRANSPARENCY AND COOPERATION

Guiding Principle 1

OBJECTIVE, INDEPENDENCE, POWER, TRANSPARENCY AND COOPERATION

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

LICENSING AND OWNERSHIP

Guiding Principle 2

PERMISSIBLE ACTIVITIES

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

Guiding Principle 3

LICENSING

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

Guiding Principle 4

OWNERSHIP

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

PRUDENTIAL REGULATION AND REQUIREMENTS

Guiding Principle 5
CAPITAL ADEQUACY

The supervisory authority must establish and enforce the rules for an appropriate capital framework with which all regulated institutions must comply. The rules should balance cooperative principles and objectives with the need to protect depositors. Accordingly, supervisory authorities will need to carefully consider what meets the criteria for capital and to ensure that capital instruments are able to absorb losses in the event of failure.

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

Guiding Principle 6
RISK MANAGEMENT

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

Guiding Principle 7
CREDIT RISK

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

Guiding Principle 8
PROBLEM ASSETS, PROVISIONS AND RESERVES

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

Guiding Principle 9
LARGE EXPOSURES

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

Guiding Principle 10
CONFLICTS OF INTEREST AND RELATED PARTY EXPOSURES

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

Guiding Principle 11
INTEREST RATE RISK AND MARKET RISK

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

Guiding Principle 12
LIQUIDITY AND FUNDING RISK

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

Guiding Principle 13
INTERNAL CONTROLS

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

Guiding Principle 14

ABUSE OF FINANCIAL SERVICES

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

Guiding Principle 15

OPERATIONAL RISK

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

METHODS OF ONGOING SUPERVISION

Guiding Principle 16

INTERNAL AUDIT

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

Guiding Principle 17

SUPERVISORY ACCESS

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

Guiding Principle 18

SUPERVISORY APPROACH, TECHNIQUES AND RESOURCES

The supervisory authority should develop and maintain a thorough understanding of the operations of individual regulated institutions and should deploy an effective and ongoing combination of offsite and onsite supervisory techniques. The supervisory authority should have appropriately qualified and independent staff and be adequately resourced to implement its supervisory approach.

Guiding Principle 19

SUPERVISORY REPORTING

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

ACCOUNTING AND DISCLOSURE

Guiding Principle 20

ACCOUNTING AND DISCLOSURE

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

ENFORCEMENT

Guiding Principle 21

CORRECTIVE AND REMEDIAL POWERS OF THE SUPERVISORY AUTHORITY

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

The **INTERNATIONAL CREDIT UNION REGULATORS' NETWORK** (ICURN) created this document in September 2011 as guidance for supervisory authorities involved in the prudential supervision of cooperative financial institutions to establish an environment that facilitates effective supervision.

ICURN recommends the adoption of these guiding principles for all jurisdictions supervising financial cooperatives. Recognizing that supervisors operate in a wide range of systems and the principles may not always be applicable or relevant in all circumstances, ICURN encourages supervisory authorities to focus on the guiding principles' goals.

While a high degree of adoption of these principles should facilitate more effective supervision, it will not prevent individual institution failures. Prudential supervision cannot, and should not, provide an assurance that deposit-taking institutions will not fail.

These principles have been developed using the Basel Committee on Banking Supervision's Core Principles for Effective Banking Supervision as a guide. ICURN is grateful for the Basel Committee's ongoing support, although it wishes to emphasize that this document was developed independently by the ICURN steering committee and is not endorsed in any way by the Basel Committee.

ICURN Secretariat
c/o World Council of Credit Unions
P.O. Box 2982
Madison, WI 53701-2982 USA
Phone: +1-608-395-2000
Fax: +1-608-395-2001

mail@curegulators.org
www.CUregulators.org

The **Guiding Principles** were developed by the **INTERNATIONAL CREDIT UNION REGULATORS' NETWORK** (ICURN), an independent international network of credit union regulators that was formed in 2007 and currently has members in 30 countries and jurisdictions. ICURN's mission is to promote greater international coordination among regulators of financial cooperatives through the sharing of information and positions of common interest, initiating research on financial cooperatives and their oversight, identifying best practices and providing direct access to an exclusive forum for thought leaders worldwide on issues critical to sound credit union regulation. The ICURN steering committee consists of senior representatives of the supervisory authorities for cooperative financial institutions in Australia, Brazil, Canada, India, Kenya, Poland and the United States. World Council of Credit Unions serves as the ICURN secretariat. Visit **www.CUregulators.org** to learn more.