



## Version 1 and Version 2 – what is the difference?

On 1<sup>st</sup> December 2001 the Registry of Friendly Societies ceased to exist and the Financial Services Authority took over the Registrar's powers for credit unions. From 1<sup>st</sup> July 2002 the FSA has the full range of powers and tools of the Financial Services and Markets Act to apply to their regulation and supervision of credit unions.

As from 1<sup>st</sup> July 2002, credit unions were expected to be fully compliant with the FSA's Rules and maintain at least the minimum prudential standards established within CRED.

**Part IV of the Financial Services and Markets Act** introduces a new process following the registration of a credit union. A Part IV permission gives a credit union **authorisation** to undertake deposit-taking business. There are 2 variations of this deposit taking permission - Version 1 requirements and Version 2 requirements. The main differences are summarised in the following table along with other changes that have affected all credit unions under the new regime.

Proposal	Version 1 Requirements	Version 2 Requirements
<b>Authorisation Required:-</b> All credit unions need a Part IV permission <sup>1</sup> for "deposit-taking"	a deposit-taking permission with restrictions attached.	a deposit-taking permission
<b>Size of credit union</b>	All credit unions, regardless of size, can choose to operate under Version 1 requirements  Two size thresholds cause a change to the regulatory regime (particularly in relation to capital requirements) <ul style="list-style-type: none"><li>◆ 5,000 members or £5 million in assets (5% capital required)</li><li>◆ 10,000 members or £10 million in assets (8% capital required)</li></ul>	All credit unions with an 8% or greater capital-assets ratio can apply to operate under Version 2 requirements. There are no minimum member or asset size requirements to operate as a Version 2. Operating as a Version 2 credit union enables the provision of a greater range of services to their members than permitted under Version 1 requirements. Can also apply to be authorised as V2 from outset.
<b>Business permitted</b>	A "traditional range" of services eg: savings, loans, certain other ancillary activities	Larger loans over longer periods. The ability to offer variable dividends on different term savings accounts, and the ability to offer a dividend more often than annually is likely to be limited to Version 2 credit unions only.

<sup>1</sup> The "deposit-taking" permission is contained within Part IV of the Financial Services and Markets Act



Proposal	Version 1 Requirements	Version 2 Requirements
<b>Main distinction</b>	Restricted in the amount of money lent and the length of the repayment period. Restricted on investment and borrowing opportunities.	Able to provide larger loans over longer periods. Able to offer variable dividend savings accounts and declare a dividend more often than annually Able to borrow and invest over longer periods than Version 1
<b>Type of FSA supervision</b>	Desk based, analysis of returns, occasional visits. Focus on establishing compliance standards in reports	Enhanced reporting requirement (including policies and business plans), risk-based approach to supervision

Savings	Version 1	Version 2
<b>Maximum savings per member</b>	£5000 or 1.5% of total shareholdings, whichever is the greater	£5000 or 1.5% of total shareholdings, whichever is the greater

Loans	Version 1	Version 2
<b>Repayment period - unsecured</b>	3 years	5 years
<b>Repayment Period - secured</b>	7 years	15 years
<b>Maximum Loan Value</b>	Dependent on capital-assets ratio: less than 5% → shares + £5,000 more than 5% → shares + £10,000	Shares + £10,000 or 1.5% of total shares in CU in excess of members shareholding, whichever is the greater.(subject to large exposures limits)

Loans	Version 1	Version 2
<b>Maximum large exposure on single loan</b>	25% of capital	25% of capital
<i>(Large exposure = individual's net liability = at least: £5,000 and 10% of total capital)</i>		
<b>Maximum large exposure limit – aggregate loans</b>	300% 500% - maximum limit (over 300% requires pre-notification)	300% 500% - maximum limit (over 300% requires pre-notification)



Loans	Version 1	Version 2
<b>Bad debt provision</b>	The FSA Rules require a specific provision to be made for debts more than 3 and more than 12 months in arrears. The General Provision requirement of 2% of loans is an evidential provision.	
<b>General provision</b>	2% of loans	2% of loans
<b>&gt; 3 months in arrears</b>	35% of net liability	35% of net liability
<b>&gt; 12 months in arrears</b>	100% of net liability	100% of net liability

Capital	Version 1	Version 2
<b>Positive net worth requirement</b>	Members savings must retain their full value at all times	Members savings must retain full value at all times
<b>Retained profits requirement</b>	Until reserves equal 10% of total assets, 20% of surplus should be transferred to general reserve	Not applicable – a V2 credit union is not required to make a minimum transfer to reserves but minimum 8% capital-assets ratio must be maintained
<b>Capital-assets ratio</b>	Level of capital-asset ratio affects size of loan a credit union can offer – see “Maximum Loan Value”. In addition, a Version 1 credit union that reaches a specified size is required to operate under the enhanced capital requirements as follows: <ul style="list-style-type: none"> <li>◆ 5% if more than 5,000 members or £5 million in assets</li> <li>◆ 8% if more than 10,000 members or £10 million in assets</li> </ul>	At least 8% capital required at all times
<b>Minimum initial capital requirement for new credit unions (eg. raised by joining fees, grant funding, or subordinated loans)</b>	£1,000	£5,000
<b>Individual capital requirements</b>	May be imposed by FSA if deemed necessary	8% plus (eg: if diversifying into new business or CU has weak systems and controls)



Liquidity	Version 1	Version 2
Liquid assets	10% of total relevant liabilities. May be breached by up to 5% at times of very high demand. However, 2 consecutive reports showing such a breach will not be permitted.	5% of total relevant liabilities
Borrowing & Investments	Version 1	Version 2
<b>Investing in Government securities</b>	Only securities with maturity of less than 12 months	Only securities with maturity of less than 5 years
<b>Aggregate borrowings from banks, CUs, etc</b>	Not to exceed 20% of total shareholdings for more than two consecutive quarters (Subordinated debt used to build capital is not included in this requirement)	Not to exceed 50% of total shareholdings (Section 10 of CUA79) (Subordinated debt used to build capital is not included in this requirement)

Reporting Requirements	Version 1	Version 2
<b>Audited Annual Returns</b>	Submitted within 7 months of year end	Submitted within 7 months of year end
<b>Quarterly</b>	Submitted within one month of quarter end	Submitted within one month of quarter end
<b>Regulatory Business Plan and Policy and Procedures Manual</b>	Maintain a current business plan and a comprehensive set of policies and procedures	Maintain a current business plan & comprehensive set of policies & procedures provide updated versions to FSA.



## Other FSA Regulatory Requirements

There are some other FSA regulatory requirements, which are the same for all credit unions, regardless of whether they are subject to Version 1 or Version 2 requirements. These requirements and proposals are as follows:

<b>Auditors</b>
Provision of auditor's details to FSA. Gateway of information between FSA and auditor – auditor will have a statutory duty to report certain matters to the FSA – such as ongoing compliance with the prudential requirements and any breach of the threshold conditions. The auditor will be expected to report matters which give cause for concern and which may ultimately jeopardise the security of members' funds
<b>Approved Persons Regime (APER) –</b>
The Approved Persons regime will be applied to all credit unions. Individuals carrying out a controlled function on 1 <sup>st</sup> July 2002 will be “grandfathered” in post into the new regime. New directors taking up post on or after 1 <sup>st</sup> July 2002, or directors changing functions, will be required to seek approval under the approved persons regime
<b>Application of Approved Persons Regime (APER)</b>
Approved persons required to sign a statement attesting to the fact that they are “fit and proper” this includes: <ul style="list-style-type: none"><li>◆ honesty, integrity and reputation</li><li>◆ competence and capability</li><li>◆ financial soundness</li></ul> Approved person can be subjected to disciplinary action for misconduct or lack of compliance. FSA aims to process straightforward applications within 7 working days..
<b>Controlled Functions</b> include: Director function – includes chairman, vice chairman, secretary; Non-executive director function – includes supervisory committee, Chief Executive Officer, Senior Manager Internal Audit Function – includes supervisory committee Money Laundering Reporting function
<b>Disciplinary action</b> against the individual or firm following misconduct (personal culpability) Could include – personal fines, withdrawal of approval, public censure and prohibiting from holding similar post in another credit union. The FSA aim to apply their enforcement powers proportionally, taking into account the full history of the case, seriousness of the breach and previous regulatory history.
<b>Misconduct by an approved person</b> for which disciplinary action can be taken includes: deliberately misleading customers, or the FSA. Deliberately failing to inform of a material fact, deliberately preparing inaccurate or misleading records, failing to take reasonable steps to inform themselves about the affairs of the business.



<b>Enforcement Powers</b>	
Powers taken against a credit union <u>or</u> an individual if a credit union <u>or</u> an individual has broken a rule or other regulatory requirement, or in order to prevent a breach	Disciplinary action, gathering information, conduct investigations, vary or cancel permissions (eg: limit number of members, impose maximum shareholding, prevent new business), public statements of misconduct, financial penalties, bring court proceedings, prohibit individuals from holding post.

  

<b>Money Laundering Prevention</b>	
Money Laundering Reporting Officer's Responsibilities:	<ul style="list-style-type: none"><li>• monitor operation of the credit union's anti-money laundering policies</li><li>• establish and maintain arrangements for staff awareness and training</li><li>• receive reports on suspicion of money laundering</li><li>• report to National Criminal Intelligence Service</li><li>• Complete an annual compliance and monitoring report</li></ul>
Records required	<ul style="list-style-type: none"><li>• "Know your customer" information on financial circumstances and transactions of members in readily accessible records</li><li>• Copies of the two pieces of identification evidence</li><li>• Record of every transaction carried out</li><li>• Internal and external money laundering reports</li></ul>