



Version 1 and Version 2 – what is the difference?

Part IV of the Financial Services and Markets Act determines the 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.

All credit unions must adhere to the High Level Standards outlined in the Handbook

Principles for Business

Threshold Conditions

Approved Persons Regime

Senior Management, Systems and Controls

Proposal	Version 1 Requirements	Version 2 Requirements
Authorisation Required:- All credit unions need a Part IV permission ¹ for “deposit-taking”	a deposit-taking permission with restrictions attached.	a deposit-taking permission
Other permissions may be Mortgage and or Insurance Permissions		
Size of credit union	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"> • 5,000 members or £5 million in assets (5% capital required) • 10,000 members or £10 million in assets (8% capital required) 	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.
Business permitted	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.
Main distinction	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
Type of FSA supervision	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

¹ The “deposit-taking” permission is contained within Part IV of the Financial Services and Markets Act

Savings	Version 1	Version 2
Maximum savings per member	£10,000 or 1.5% of total shareholdings, whichever is the greater	£10,000 or 1.5% of total shareholdings, whichever is the greater
Dividend	Different dividend payable on different accounts provided that at the time of payment the it has a capital/asset ratio of at least 5% and the payment of the dividend does not reduce the ratio to below 5%. Dividend payable only once per year. Maximum of 8%	Different dividend payable on different accounts and can be paid twice per year if required. Maximum of 8%

Loans	Version 1	Version 2
Repayment period - unsecured	5 years	10 years
Repayment Period - secured	10 years	25 years
<i>Maximum Loan Value</i>	Dependent on capital-assets ratio: less than 5% → shares + £7500 more than 5% → shares + £15000	Shares + £15,000 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
Maximum large exposure on single loan	25% of capital	25% of capital
<i>(Large exposure = individual's net liability = at least: £7500 and 10% of total capital)</i>		
Maximum large exposure limit – aggregate loans	300% 500% - maximum limit (over 300% requires pre-notification)	300% 500% - maximum limit (over 300% requires pre-notification)
Bad debt provision	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.	
General provision	2% of loans	2% of loans
> 3 months in arrears	35% of net liability	35% of net liability
> 12 months in arrears	100% of net liability	100% of net liability



Capital	Version 1	Version 2
Positive net worth requirement	Members savings must retain their full value at all times	Members savings must retain full value at all times
Retained profits requirement	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
Capital-assets ratio	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"> • 5% if more than 5,000 members or £5 million in assets • 8% if more than 10,000 members or £10 million in assets 	At least 8% capital required at all times
Minimum initial capital requirement for new credit unions (eg. raised by joining fees, grant funding, or subordinated loans)	£1,000	£5,000
Individual capital requirements	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
<i>Liquid assets</i>	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
Investing in Government securities	Only securities with maturity of less than 12 months	Only securities with maturity of less than 5 years
Aggregate borrowings from banks, CUs, etc	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
Audited Annual Returns	Submitted within 7 months of year end	Submitted within 7 months of year end
Quarterly	Submitted within one month of quarter end	Submitted within one month of quarter end
Regulatory Business Plan and Policy and Procedures Manual	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:

<p>Auditors</p> <p>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</p>
<p>Approved Persons Regime (APER) –</p> <p>The Approved Persons regime will be applied to all credit unions. Individuals carrying out a controlled function on 1st July 2002 will be “grandfathered” in post into the new regime. New directors taking up post on or after 1st July 2002, or directors changing functions, will be required to seek approval under the approved persons regime</p> <p>Application of Approved Persons Regime (APER)</p> <p>Approved persons required to sign a statement attesting to the fact that they are “fit and proper” this includes:</p> <ul style="list-style-type: none"> • honesty, integrity and reputation • competence and capability • financial soundness <p>Approved person can be subjected to disciplinary action for misconduct or lack of compliance. FSA aims to process straightforward applications within 7 working days..</p>
<p>Controlled Functions include:</p> <p>Director function – includes chairman, vice chairman, secretary;</p> <p>Non-executive director function – includes supervisory committee, Chief Executive Officer, Senior Manager</p> <p>Internal Audit Function – includes supervisory committee</p> <p>Money Laundering Reporting function</p>
<p>Disciplinary action 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.</p>
<p>Misconduct by an approved person 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.</p>



Enforcement Powers	
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.

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