



FINANCIAL REGULATOR  
*Rialtóir Airgeadais*

# Regulatory Reserve Ratio for Credit Unions

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Registry of Credit Unions



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# Introduction

Adequate reserves are the foundation on which the financial stability of a credit union rests. Adequate reserves support a credit union's operations, provide a base for future growth and protect against the risk of unforeseen losses. Credit unions need to maintain sufficient reserves to ensure continuity and to protect members' savings. Adequate reserves maintain savers' confidence.

A strong overall reserves position enables credit unions to deal with future uncertainties and to act flexibly in adverse economic conditions. Lack of adequate reserves may threaten the financial soundness, stability and future of a credit union.

The recent turmoil in global financial markets has highlighted the importance for all financial institutions to ensure they have sufficient reserves to support their undertakings and maintain confidence in the financial system. Furthermore, the difficult economic environment that credit unions are currently experiencing places increased emphasis on the requirement for credit unions to ensure they are maintaining adequate reserves.

**Accordingly, with effect from 30 September 2009, all credit unions are required to maintain a Regulatory Reserve Ratio of not less than 10 per cent on an on-going basis.**

The Regulatory Reserve Ratio is defined in Section 1. The implementation timeframe for credit unions that are unable to meet the Regulatory Reserve Ratio by 30 September 2009 is set out in Section 2. In the financial year commencing 1 October 2010, an option will be made available for credit unions that can meet certain criteria to calculate their Regulatory Reserve Ratio based on their risk profile. The proposed risk based approach is outlined in Section 3.

# 1. Regulatory Reserve Ratio

In accordance with the Credit Union Act 1997 (Section 85) Rules 2009, (“the Rules”), **credit unions are required to maintain a Regulatory Reserve Ratio of not less than 10 per cent with effect from 30 September 2009.**

This document sets out conditions to which credit unions must adhere in the application of the Rules. If any credit union does not adhere to these conditions, the credit union will be in breach of the Rules and may be subject to regulatory action by the Registrar of Credit Unions (“the Registrar”).

Reserves available to a credit union for the purposes of the Regulatory Reserve Ratio must be **realised<sup>1</sup>, unrestricted and non-distributable.**

The Regulatory Reserve Ratio is defined as **“the amount held in the Total Regulatory Reserve of a credit union expressed as a percentage of the Total Assets<sup>2</sup> of a credit union”.**

The **Total Regulatory Reserve** is comprised of the Statutory Reserve and where relevant any amount held in a non-distributable additional regulatory reserve account.

A minimum of 8 per cent of total assets must be held in the Statutory Reserve. The remaining 2 per cent of total assets required to meet the Regulatory Reserve Ratio may be held either in the Statutory Reserve or in a reserve account called the “Additional Regulatory Reserve”<sup>3</sup>, which must be clearly identified as non-distributable.

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<sup>1</sup> Regulatory Reserves must be freely available to cover risk. Unrealised surpluses that may not materialise cannot be relied upon to support the financial structure of a credit union. Accordingly unrealised reserves may not be included in the Regulatory Reserve Ratio.

<sup>2</sup> Total Assets of the credit union after allowance for provisions for bad and doubtful debts.

<sup>3</sup> Credit unions must ensure that the Statutory Reserve represents 8 per cent of total assets before an “Additional Regulatory Reserve” is created.

The Regulatory Reserve Ratio sets out the minimum requirement for each credit union. **However, credit unions are expected to operate with a level of reserves above the regulatory minimum.** It is for the board of directors of each credit union to decide on the amount of reserves to hold in excess of this minimum requirement, taking prudent account of the scale and complexity of the credit union's business, its risk profile and prevailing market conditions.

It is recommended that credit unions whose total reserves are currently in excess of 10 per cent of total assets continue to maintain reserves at existing levels – at least.

Where it is considered appropriate, the Registrar may set a ratio for a credit union, or a category of credit unions, that is higher than the minimum Regulatory Reserve Ratio.

**Credit unions must remain in compliance with the Regulatory Reserve Ratio on an ongoing basis.**

The board of directors of the credit union must inform the Registrar immediately should the Regulatory Reserve Ratio fall below 10 per cent and take the appropriate measures to restore the ratio to the required level as soon as possible. The timeframe in which the ratio will return to compliance must be agreed with the Registrar.

**It should be noted that credit unions must continue to allocate surplus funds to the Statutory Reserve in respect of each financial year in accordance with the provisions of Section 45 of the Credit Union Act, 1997<sup>4</sup>.**

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<sup>4</sup> Any investment income that has been included in the Income and Expenditure Account and which "will not be received within 12 months of the Balance Sheet date" cannot be included in the Total Regulatory Reserve. When such income "will be received within 12 months of the Balance Sheet date" it can then be transferred to the Total Regulatory Reserve or distributed, whichever is appropriate.

## 2. Timeframe for Implementation

**All credit unions are required to maintain, on an ongoing basis, a Regulatory Reserve Ratio of not less than 10 per cent, with effect from 30 September 2009.**

The board of directors of each credit union is responsible for achieving and maintaining the minimum Regulatory Reserve Ratio of 10 per cent. **This must be achieved at 30 September 2009 where credit unions have the capacity to do so.** (See also Year-End Considerations on Page 6.)

Where a credit union's Regulatory Reserve Ratio is less than 10 per cent, the credit union must transfer other **realised** reserves<sup>5</sup> to the Total Regulatory Reserve in order to bring the Regulatory Reserve Ratio up to the required minimum.

Where a credit union does not have adequate reserves to meet the Regulatory Reserve Ratio by 30 September 2009, the board of directors of the credit union must provide the Registrar with a plan for achieving compliance. Such credit unions must achieve the Regulatory Reserve Ratio within the shortest timeframe possible, but not later than the timeframes and percentages set out below:

- 30 September 2009 – Regulatory Reserve Ratio of at least 7½ per cent;
- 30 September 2010 – Regulatory Reserve Ratio of at least 8 per cent;
- 30 September 2011 – Regulatory Reserve Ratio of at least 8½ per cent;
- 30 September 2012 – Regulatory Reserve Ratio of at least 9 per cent;
- 30 September 2013 – Regulatory Reserve Ratio of at least 10 per cent.

Credit unions that are unable to meet the Regulatory Reserve Ratio in accordance with the timeframe outlined above may be subject to certain restrictions in their business to take account of their low reserve base.

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<sup>5</sup> The required amount may be transferred to the Statutory Reserve or the "Additional Regulatory Reserve" bearing in mind that the Statutory Reserve must be maintained at a minimum of 8 per cent.

## Year-End Considerations

Where a credit union reports a surplus for the year but the Regulatory Reserve Ratio is less than 10 per cent, or would be less than 10 per cent following payment of a dividend, the credit union must contact the Registrar to discuss any proposals to pay a dividend. In such circumstances payment of a nominal dividend<sup>6</sup> may be appropriate.

Any credit union that reports a deficit for the year cannot pay a dividend. However, in certain exceptional circumstances this requirement may be reviewed. For example, any credit union that reports a deficit and has a Regulatory Reserve Ratio of more than 10 per cent may contact the Registrar with a proposal regarding the payment of a nominal dividend<sup>7</sup>, from a reserve set aside in previous years to provide for dividends.

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<sup>6,7</sup> It is expected that the nominal dividend will be subject to a maximum of 1%.

### 3. Proposed Risk Based Approach

In the financial year commencing 1 October 2010, an option will be made available for credit unions that meet certain criteria to calculate the Regulatory Reserve Ratio based on their risk profile. The risk based Regulatory Reserve Ratio will be developed in accordance with the following guiding principles:

- Credit unions wishing to move to a risk based Regulatory Reserve Ratio will be subject to an approval process which will include auditor sign-off. As part of the approval process, credit unions will be required to have proper skills, expertise, risk management, accounting and IT systems in place.
- Under this system, credit unions with a lower risk profile will have the opportunity to operate with a lower minimum level of regulatory reserves commensurate with their risk profile.
- Credit unions that have been approved to move to a risk based approach will be required to maintain the higher of:
  - a Regulatory Reserve Ratio of 8 per cent of total assets; and
  - the risk based Regulatory Reserve Ratio.
- Risk weightings will be assigned to the various classes of credit union assets by virtue of a number of criteria including asset quality and maturity profile.
- Auditor confirmation of compliance with the risk based Regulatory Reserve Ratio and the related conditions of approval will be required on a periodic basis.
- Compliance with the risk based Regulatory Reserve Ratio will be monitored through the Prudential Return on an ongoing basis.



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