



World  
Council  
of Credit  
Unions, Inc.

# International Credit Union Safety and Soundness Principles

The International Credit Union Safety and Soundness Principles identify prudential standards intended to safeguard credit union members' savings from losses and to ensure credit unions function in a sound manner. While each credit union must comply with local regulatory requirements and prudential standards, the International Credit Union Safety and Soundness Principles offer a best practices guide based on World Council's extensive experience in the development of credit unions worldwide.

## Delinquency

Loans that are not paid as agreed are considered delinquent the day after the first missed payment. The entire outstanding loan balance is considered past due. Immediate action should be taken to control delinquency and collect when a loan is reported past due. World Council recommends that loans past due more than 30 days comprise less than 5% of the total portfolio. When a loan becomes delinquent, the credit union should not grant new loans to pay off the outstanding capital and interest for the same borrower.

## Loan Loss Provisioning

Provisions for loan losses are the *first line of defense* to protect savings against identified risk of losses to the credit union. Many countries and credit union systems apply a tiered system of provisioning for delinquency. Although local regulatory standards may provide a more stringent policy on loan loss provisioning, based on historical experiences, World Council recommends at least 35% of loans past due from one to twelve months be provisioned into an allowance account. World Council also recommends loans more than twelve months past due be provisioned at a 100% and consequently written off the credit union's books as a loss on a quarterly basis. Although a loan may be written off on its books, the credit union should still seek to collect payment for the outstanding loan.

## Institutional Capital

Institutional capital is the *second line of defense* to protect savings. Each year, a portion of the credit union's earnings should be set-aside in reserves used to cover losses from unforeseen or catastrophic problems. Since institutional capital is owned collectively by the membership with no individual direct claim on the capital, these reserves should allow the credit union to support high return rates on savings, maintain low costs on loans, create additional reserves or invest in additional services.

To ensure capital adequacy, World Council recommends credit unions maintain a capital level of 10% of total assets whereas the Basel Accord requires credit unions to maintain a capital level 8% of risk weighted assets. In markets where credit unions and their regulators have the capacity to generate a risk-weighted asset capital calculation, credit unions should utilize a risk-weighted assets standard equivalent.

## Non-Earning Assets

Assuming it meets its capital targets, the credit union should limit non-earning assets, such as land, buildings, vehicles, furniture and cash owned by the credit union, to a maximum of 5% of the total credit union assets and invest 95% of its funds into those assets that earn a return greater than the cost of funds and operating costs.

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## Pricing

Credit unions should offer competitive, entrepreneurial pricing which covers all costs of operations. From loans and investments, it is recommended that credit unions have sufficient income to cover cost of funds, operating costs, provisions for loan losses and the accumulation of institutional reserves.

## Operating Costs

Credit unions should maintain efficiency by limiting operating costs at or below levels supported by local market margins.

## Liquidity

To meet the demands of operational expenses, loan disbursements and withdrawals by savers, World Council's experience has found credit unions should maintain a minimum ratio of 15% of withdrawable savings in easily accessible instruments and accounts.

## Diversification

A credit union should limit the risk of concentrating the loan portfolio in one or a few related loans. World Council recommends the maximum amount of related aggregate loans or credits be 5% of the credit union's total assets or 10% of its institutional capital.

## Non-Financial Operations

Credit unions specialize in financial intermediation and should not implement non-financial operations such as retail store operations. World Council recommends the sum of non-financial investment not exceed 5% of total assets.

### Annex A: International Credit Union Safety & Soundness Principles<sup>1</sup>

<i>PROTECTION</i>	<i>Performance Indicators</i>	<i>Minimum Prudential Norm</i>
	Allowance for Loan Losses / Delinquency >12 Mo.	100%
	Net Allowance for Loan Losses / Delinquency 1-12 Mo.	35%
	Complete Loan Charge-Off of Delinquency > 12 Mo.	Yes
	Solvency	100%
	<i><u>EFFECTIVE FINANCIAL STRUCTURE</u></i>	
	Institutional Capital / Total Assets	10%
	<i><u>ASSET QUALITY</u></i>	
	Total Delinquency / Total Loan Portfolio	Less Than 5%
	Non-Earning Assets / Total Assets	Less Than 5%
	<i><u>RATES OF RETURN AND COSTS</u></i>	
	Net Loan Income / Average Net Loan Portfolio	Entrepreneurial Rate
	Net Income / Average Assets	Enough to reach the goal for Institutional Capital
	<i><u>LIQUIDITY</u></i>	
	Liquid Assets - ST Payables / Total Deposits	15%
	Liquidity Reserves / Total Savings Deposits	10%

<sup>1</sup> The International Credit Union Safety and Soundness Principles consist of a set of performance indicators, each with a minimum prudential norm that credit unions should meet. The target indicators have been developed based on WOCCU's field experience with credit unions globally. To assist credit unions and their regulators in monitoring financial performance relative to these Principles, WOCCU has developed and makes available the software monitoring system called PEARLS™.