

Quayside House
127 Fountainbridge
Edinburgh
EH3 9QG

Tel: +44 (0)131 301 2000
Fax: +44 (0)131 557 6756
www.fca.org.uk

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This letter is historical. See our [supervisory correspondence page](#) for more information and current views.

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Dear Board of Directors

FCA strategy for Credit Unions

The last 2 years have been challenging for consumers, firms and businesses. During the pandemic, the FCA and firms have worked well together. For instance, FCA guidance led to 4.5m payment deferrals for mortgage and credit customers. This gave security and protection to consumers in the face of instability and uncertainty.

The FCA is transforming to deal with the rapid changes in the markets it regulates. This includes the innovation, digitalisation, and changing consumer needs that are emerging.

We are becoming more innovative, making greater and more effective use of data and technology to act faster and more decisively. We are becoming more assertive - making full use of our powers, helping others to use theirs, and playing our part in tackling issues that don't sit neatly within our regulatory perimeter. We are becoming more adaptive, building on our response to the pandemic and changing our approach more quickly as the world changes around us.

The pandemic is likely to remain a significant influence on the work of both firms and the regulator. This includes helping those in financial difficulty, where the Credit Union sector plays an important role. The FCA will continue monitoring how firms tailor support and tackle areas of greatest harm.

Purpose of this letter

As part of our approach to supervision, we have recently reviewed the key risks of harm that are present for Credit Unions, their members, and the markets in which they operate. This follows on from our previous review, and our letter to you in August 2018. In this letter, we:

- Provide an updated view of the key risks of harm we believe are present for this sector
- Outline our expectations of firms
- Provide an overview of our strategy and programme of work to ensure that firms are meeting our expectations, and harms are being appropriately remedied

We expect you to consider the degree to which your firm presents such risks and to review your strategies for mitigating them. In circumstances where we have contact with your firm,

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we will expect you and your senior managers to be able to demonstrate that you are taking reasonable steps to mitigate these risks.

Our view of the portfolio

We recognise that the increased coronavirus-related restrictions placed on many areas of the UK since the start of the pandemic has led to heightened financial difficulty for some members of Credit Unions, and that many will continue to live in financial uncertainty as the impact of coronavirus continues.

In this assessment, we have considered the continuing impact of the pandemic recognising that it, and the restrictions imposed to control it, created significant challenges for firms and members that could not have been anticipated. Given the unprecedented impact of the pandemic, we expect firms to be aware of the difficult circumstances that some members find themselves in and to consider very carefully the individual needs of their members and show flexibility in their treatment of them.

Below we outline what we consider to be the key risks of harm to members and outline our expectations of firms, alongside our planned strategy to ensure that firms are meeting these expectations, and harms are being appropriately remedied.

Our view of the key risks of harm to members of Credit Unions

Governance

- Credit Unions fail to have effective governance arrangements in place leading to poor oversight, systems and controls. This prevents firms being able to effectively implement risk management frameworks, leading to risks of harm going undetected and resulting in member harm. Credit Unions fail to ensure that the information stored on the [Financial Services Register](#) is always updated. This prevents members being able to contact the appropriate person in a timely manner.
- Credit Unions are unable to attract and retain new Board members and Directors. Boards should proactively plan for the future, in particular ensuring succession planning. This supports effective governance which is fundamental to the viability of the business and to ensuring good consumer outcomes.

Operational issues, including financial resilience

- Credit Unions fail to have adequate systems and controls, policies and procedures in place to mitigate the risk of operational events, resulting in a failure to oversee the risk of harm to members. This includes systems failures and outages that lead to services being unavailable to members or to data breaches. Credit Unions relying on outsourcing arrangements fail to implement effective monitoring and oversight of third-party providers resulting in the risk of member harm not being effectively managed and prevented.

- As more Credit Unions move their services online, we have seen a risk of increased cyber threats and consumer scams, posing greater risks to members as some firms are insufficiently equipped to manage these.
- Credit Unions with weak systems and controls and a lack of training, are increasingly susceptible to the risks of fraud and financial crime. This includes being aware of the money laundering risks that a Credit Union is exposed to and ensuring that the financial crime controls are sufficient. Insufficient controls could lead to loss of members' assets.
- The legislative horizon in Great Britain may be changing, and Credit Unions might expand the range of products and services they offer. Offering new products can potentially present different and higher risks to members, as well as benefits. Clear responsibility for these processes, through the Senior Manager Regime, is a priority to ensure fair outcomes for, and treatment of, members.

Fair treatment of members

- Credit Unions fail to recognise and address the needs and challenges facing members in vulnerable circumstances and fail to ensure that they obtain the same fair outcomes as other members.
- During the pandemic there was a risk that Credit Unions may have had to take longer than usual to answer complaints which could have led to a reduction in the quality of complaint handling. Credit Unions should ensure they continue to aim to meet the relevant obligations, including investigating complaints competently, diligently, and impartially, cooperating with the Financial Ombudsman Service and paying appropriate redress or making other appropriate remediation where necessary.

Financial resilience

- Liquid resources are critical for firms' survival and to help ensure that they meet their obligations as they fall due. Credit Unions should monitor their financial health as part of appropriate systems and controls, for example, through cash-flow forecasts, and always maintain adequate financial resources. The role of liquidity monitoring is more relevant given the strain coronavirus has put on firms' financial resources, with a heightened risk of firm failure.

Failure to manage resources may mean a Credit Union fails to meet its obligations as they fall due, leading to it exiting the market in a disorderly fashion. This could leave members without clear information about the status of their accounts, including who to contact and when, thereby impacting their ability to make ongoing payments, resolve issues or make settlement.

Our expectations and areas of focus

Our work is therefore prioritised to focus on the following:

Operational resilience and third-party providers

Appropriate systems and controls, alongside effective policies, and procedures, that deliver adequate governance and oversight of third-party providers is critical to ensuring firms operate

with the interests of their members being paramount. The Prudential Regulation Authority (PRA) also wrote to the sector about this on [21 October 2021](#).

Where Credit Unions do use third-party providers, they need to effectively manage these relationships to reduce the risk of operational disruption and harm to their members. Last year we wrote to firms who engage the outsourcing services of [third-party providers](#) to remind them of their responsibilities and what they are accountable for. The key details have been included in Appendix 1. Along with your outsourcing partners you should review arrangements in place to ensure that both sides effectively deliver on the above.

We expect your Credit Union to be operationally resilient by having a comprehensive understanding and mapping of the people, processes, technology, facilities, and information necessary to deliver each of your important business services.

Outsourcing and data security

We expect Credit Unions to manage the amount of data being stored, processed, or transmitted by third-party providers on behalf of the firm, and how critical to operations that data is. This includes how Credit Unions configure and monitor their services to reduce the potential for security and compliance incidents.

Firms should implement an appropriate level of security to protect outsourced data, including for relevant data protection requirements.

Risk management of outsourcing

Credit Unions should have appropriate risk management systems and controls to manage the risks associated with the provider, including:

- The risk management of third-party relationships, whether counted as outsourcing or not, e.g. [SYSC 3.1.1R](#) and [SYSC 4.1.1R](#) as set out in our Senior Management Arrangements, Systems and Controls (SYSC) sourcebook.
- Assessing whether your Credit Union's third-party arrangements fall within the scope of the definition of outsourcing so that you identify the correct rules and guidance.
- Ensuring your Credit Union effectively follows the relevant rules and guidance.
- Effectively applying the rules and guidance through the extended supply chain.

Your firm is responsible and accountable for all the regulatory responsibilities that apply to outsourcing and third-party service arrangements. Credit Unions cannot delegate any part of this responsibility to a third-party.

Consumer Duty

We know that, due to the way that financial services markets operate, consumers do not always get the products and services that meet their needs or the outcomes they might expect. Consumers' ability to make good decisions can be impaired by various factors. These

include their weaker bargaining position, asymmetries of information, lack of understanding or behavioural biases.

We are proposing to introduce a new 'Consumer Duty', that would set higher expectations for the standard of care that firms provide to consumers. We consulted on specific rules and guidance in a [second consultation paper](#). This consultation closed on 15 February 2022 and we expect to publish the policy statement, summarising responses and making any new rules, by 31 July 2022.

Diversity & Inclusion (D&I)

We expect Credit Unions to understand the needs of their members and be able to respond to them when designing products and services, providing flexible customer service, and communicating with them. As set out in [DP 21/2](#), having staff and Board members from diverse backgrounds and experiences, as far as the Common Bond restrictions allow, contributes to this. Diversity & Inclusion (D&I) in regulated firms is a priority for us, and DP21/2 (which closed on 30 September 2021) and the accompanying Literature Review started the conversation on what more can be done to improve diversity and inclusion in financial services and set out the links we see between D&I and conduct risks. We shall be consulting on rules and guidance to promote diversity and inclusion in the financial services sector in 2022.

Environmental, social and governance (ESG) strategy

You will be aware of our environmental, social and governance (ESG) strategy, which sets out our target outcomes and the actions we expect to take to deliver these. Our aim is to support the financial sector in driving positive change, including the transition to net zero. You should also be aware that we recently released our [new strategy for positive change](#). The themes of building trust in the market for ESG products, and ensuring transparency along the value chain, remain at the core of our Strategy.

Borrowers in financial difficulty (BiFD)

We recently published our interim findings from the regular surveys and deep dives we have undertaken with lenders as part of the [borrowers in financial difficulty \(BiFD\)](#) project, which some Credit Unions contributed to. We have been monitoring, gathering insight and acting where we have identified concerns at individual firms. Our project is ongoing, but we want to provide stakeholders with a current insight into our interim findings to help firms deliver the best outcomes for customers needing support.

Our supervisory strategy

Our [Approach to Supervision](#), published in April 2019, sets out the purpose of, and our approach to, supervising firms and individuals. This builds on [Our Mission](#), explaining how we currently supervise around 50,000 firms serving retail and wholesale consumers.

All firms in the financial services industry are expected to conduct their activities in a way that treats consumers fairly, provides clear communications to consumers, resolves disputes and complaints fairly, and that complies with FCA Principles and FCA Handbook rules and guidance.

We expect you to reflect on the issues highlighted in this letter to challenge how your firm operates to minimise the consumer harm it may cause.

As part of our supervision of Credit Unions, we will engage with firms to discuss their business models, strategies, and cultures. Our work plan will also employ appropriate supervisory tools to test and, where necessary, mitigate the potential areas of harm. Where firms are not meeting our expectations, we will act.

Reacting to legislative changes

We continue to engage with HM Treasury colleagues as they work on the proposed legislative changes to the Credit Union Act in Great Britain. When those changes are finalised, we will ensure that the FCA Handbook is amended accordingly.

Our supervisory approach to Credit Unions

We will continue our engagement with Credit Union trade bodies, including the bi-annual joint session with the PRA.

We will engage with individual Credit Unions should we become aware of an issue which results in the potential of harm to a firm's members. Any portfolio-wide issues will be shared with all Trade Bodies to pass onto members as required. In circumstances where we see member harm or poor understanding in significant areas, we will consider further regulatory action.

We will continue to ensure that firms comply with their obligations under the Senior Managers and Certification Regime to reduce harm to members and strengthen market integrity, by creating a system that enables firms and regulators to hold people to account. We want firms to encourage staff and volunteers to take responsibility for their actions, improve conduct at all levels and provide clarity on roles and responsibilities.

Principle 11 of our Principles for Businesses requires firms to disclose to the FCA anything relating to the firm of which we would expect notice. We expect all firms in this portfolio to be aware of the requirements and guidance in SUP 15, and to submit notifications as required. This should be when an issue or event is identified, and firms should not wait until resolution to notify us. An example of where we expect to be notified is when a firm's systems have been compromised which could have a significant impact on the firm's resources or members.

Next steps

You are not required to respond to this letter however you should consider how it applies to your business and act as necessary. Firms should be able to explain what they did in response to this letter if contacted by a Supervisor.

Contact

If you have any questions, please contact your normal supervisory contact on 0300 500 0597. This is the primary point of contact for your firm's interactions with the FCA. You can also email us at firms.queries@fca.org.uk. However, there may be times when your firm faces urgent issues of strategic importance. If this happens, please contact the Head of Department, Andrew Kay on 0131 301 2052, or at andrew.kay@fca.org.uk. If not available, then please

contact one of the managers, Graham Dorward, on 0131 301 2038 or at graham.dorward@fca.org.uk.

The content of this letter has been shared with all UK Trade Bodies and you may want to discuss the points we have made with them.

Yours faithfully

Brian Corr

Director of Retail Lending (Interim)
Supervision, Policy and Competition Division

Appendix 1

Operational resilience and third-party providers

Firms increasingly depend on third party providers and outsourcers. This means firms need to effectively manage these providers to reduce the risk of operational disruption and harm to their consumers.

We expect your firm to be operationally resilient by having a comprehensive understanding and mapping of the people, processes, technology, facilities, and information necessary to deliver each of your important business services. This includes people and other dependencies such as third parties. Your firm should assess the risks and controls in place to ensure it is operationally resilient.

How we define outsourcing and third-party service supply

The FCA's Handbook Glossary sets out the definition of outsourcing. In most instances a firm would be outsourcing when they are involved in an arrangement where a service provider performs a process, service, or activity on behalf of a firm which the firm would otherwise carry out itself. For example, a firm can outsource the hosting of a data centre or business process to a third-party.

Third parties can also provide services that are not classed as outsourcing. For example, the acquisition of services that would otherwise not be undertaken by the firm such as the provision of vending machines, the purchase of office supplies and furniture, cleaning, statutory audit, and legal representation in court. Other services such as global network infrastructures (e.g. Visa, MasterCard), the buying of standard "off-the-shelf" software, or the purchase of market information services (e.g. provision of data by Bloomberg, Standard & Poor's) should not be considered as outsourcing.

A firm's arrangements with third parties falling outside the definition of 'outsourcing' may not be subject to specific requirements on outsourcing. They are however within the scope of the FCA's rules and guidance, particularly on governance, risk management and systems and controls. For more information, please see existing expectations on outsourcing and third-party provision below.

Existing expectations on outsourcing and third-party provisions

Firms who use these providers must take reasonable care to organise and control their affairs responsibly and effectively, with adequate risk management systems. Principle 3 and SYSC 1.2.1 in our Handbook explain this further.

Different requirements and guidance apply to different types of firms and may also depend on the type of function being outsourced. For example, whether the function being outsourced is considered critical or important, is material outsourcing, or involve important operational functions. These specific terms apply to different types of firms and are explained in the Handbook (e.g., SYSC 8 and 13), the Electronic Money Regulations 2011, the Payment Services Regulations 2017, the directly applicable MiFiD II Org Regulation covering organisational requirements and the European Supervisory Authority (ESA) Outsourcing

Guidelines. For further guidance on applying the Handbook, see the detailed application provisions and summary in SYSC 1, Annex 1 and SYSC 1.1A respectively.

Firms who use outsourced and other third-party service providers should take responsibility for managing risk arising from those arrangements. Greater levels of risk management are needed when a firm increases its dependence on outsourced and third-party service providers. This includes the delivery of services that could affect the firm's ability to remain authorised. The risks of potential harm from operational disruption can change over time and firms should manage it accordingly.

The requirements include identifying and managing the associated operational risks throughout the life span of third-party arrangements from beginning to end. We expect firms to be risk-based and proportionate, considering the nature, scale and complexity of their operations when meeting their obligations for outsourcing and third parties.