Model Regulations
for Credit Unions

World Council of Credit Unions

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Executive Summary

The degree of formal legislation and regulation for credit unions varies widely. In some countries, credit unions are subject to extensive legislation outlining their scope, function and powers, and should operate in a highly regulated environment. Yet in most countries, legislation and regulations have not been developed specifically for credit unions, or if legislation and/or regulations do exist, they are often weak and ineffective. These deficiencies are concerning because the lack of enabling regulations affects the safety and soundness of credit unions. If credit unions are to grow and to provide quality member products and services, adequate regulation is imperative.

The World Council of Credit Unions, Inc. (WOCCU) has developed the *Model Regulations for Credit Unions* (Model Regulations.) This is based on regulations from numerous countries, experience and documented best practices. It also incorporates many of the prudential ratios in WOCCU's International Credit Union Principles for Safety and Soundness and builds upon them to create a robust regulatory framework. To the best knowledge of the *Model Regulations* developers, this is the first of its kind to be developed and distributed for credit union-specific regulations.

It has been WOCCU's experience that countries looking to develop and update credit union-specific legislation benefit from having access to a universal guide that serves as a model from which to develop country specific legislation. *Model Regulations for Credit Unions* is designed to serve as a companion piece to WOCCU's *Model Law for Credit Unions*. The purpose of the *Model Regulations* is to aid credit union movement leaders, regulators and policy makers with the development of sound and appropriate regulations for credit unions. Further, it is the expectation that this *Model Regulations* serve as a catalyst to countries seeking credit union-specific regulations and to develop them using this as a reference. As such, these regulations are meant to serve as guidelines for adaptation as opposed to policy prescriptions.

The *Model Regulations* is divided into six main sections: 1) prudential regulations and operational regulations; 2) administrative regulations; 3) enforcement regulations; 4) general accounting and audit regulations; 5) deposit insurance; and 6) consumer protection regulations. Each main section is further divided into a series of regulations.

For the purpose of brevity, this executive summary discusses only 10 regulations from the complete set of 20 considered to be crucial for inclusion in the country's set of credit union regulations. Each of these regulations has an introductory paragraph describing the importance of the particular regulatory topic and any minimum requirements that the regulation should include. After each introductory paragraph, the regulation may include a definition section when needed, followed by the regulatory provision.

Regulation on Institutional Capital and Capital Adequacy

Capital adequacy requirements are the single most important regulatory requirement for the effective management of risk taking by credit unions. Capital for the purposes of calculating the capital adequacy of a credit union consists of institutional capital, defined as the sum of the funds within a credit union that are non-distributable and over which no person or outside entity has a legal claim. Institutional capital represents an accumulation of net income from prior operations in the form of retained earnings, regulatory reserves, cash donations and grants.

Ownership shares, if permanent and non-redeemable can also be a component of regulatory capital.

To calculate the capital adequacy ratio of the credit union, the credit union must divide its capital by its assets. The minimum capital adequacy ratio is 10% of total assets. Because of the importance of capital adequacy for credit unions, management should have a plan for achieving and maintaining an adequate capital level, and the board of directors should establish both short and long term goals for the institutional capital. WOCCU believes that a risk-weighted capital ratio (i.e. Basel II) should only apply to credit unions if the following conditions all apply:

a) Credit unions have a strong risk-based prudential supervision in place AND
b) Credit unions compete directly with banks that adopt Basel II AND
c) Credit unions and their prudential supervisors thoroughly understand how to calculate capital ratios under Pillar 1 of the Basel II Accord.