



# FINANCIAL SERVICES REGULATORY AUTHORITY

Reference No: CU02/2023

**Date:** May 4, 2023

**To:** All Credit Unions

**Re:** Asset Quality Require (AQR)

The Financial Services Regulatory Authority will be embarking on an Asset Quality Review (AQR) exercise for the credit union sector commencing July 1, 2023. The AQR is a prudential exercise focused on reviewing the quality of the credit unions' assets, including the adequacy of assets, collateral valuation and related provisions.

The loan portfolio of the credit unions in Saint Lucia represents approximately 40%-80% of total assets. Therefore, credit risk represents the single largest risk facing a Credit Union. Hence, the presence of a well-functioning credit risk management framework is therefore fundamental to the safety and soundness of a Credit Union.

Over the years, non-performing loans (NPLs) have been plaguing the sector. International best practices (PEARLS Monitoring System) suggest that delinquent loans should not exceed 5% of the Gross loan portfolio. The sector presents a ratio of 9% for total delinquent loans over gross loans for the year ended December 31, 2022. A high delinquency rate is indicative of institutional weakness and it usually affects all other key areas of credit union operations.

Further, our assessments have revealed that provisions for impairment of the loan portfolio for some credit unions appear to be inadequate. This is in part predicated on the notion of the sufficiency of the collateral.

**The scope of Services Required for the Asset Quality Review (AQR) includes:**

- The AQR will be carried out by an audit firm and/or other asset appraisal specialists (depending on the capabilities of the auditor).

- The AQR methodology will comply fully with the relevant accounting principles (e.g. for IFRS 9, IAS 37, IFRS 13, Regulation 30 of the Cooperative Societies Act, Cap 12.06.
- The AQR will include, but will not be limited to a review of credit union Loans to members to give an assessment of the Loan portfolio, an assessment of the current levels of NPL
- Provisioning and Collateral valuation based on agreed-upon procedures.

### **Legislative Provision**

Section 34 (8) of the Financial Services Regulatory Authority Act, Cap. 12.23 states **“The Authority may, at the expense of a regulated entity, appoint an auditor to conduct an independent audit of the regulated entity, in accordance with the instructions of the Authority, and to report the findings or results of the audit to the Authority”.**

### **Selection Process for Credit Unions**

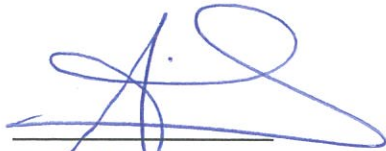
A risk-based approach will be utilized in determining the order in which the credit unions are selected taking into account the following factors:

- 1) Systemic risk to the sector  
Systemic risk is the possibility that an event at the credit union level could trigger severe instability or collapse of an entire industry or economy. Systemic risk will be assessed based on the asset size of the credit union.
- 2) The assessment of the adequacy of provisions relative to its loan portfolio  
Where the level of provisioning relative to the loan portfolio is significantly low and may deemed inadequate.
- 3) Deterioration in its loan portfolio  
The credit unions with a delinquency rate that has been consistently above the benchmark of 5%, that has eroded further, or a delinquency ratio that has varied significantly from the prior year.
- 4) Non- compliance with IFRS 9 ECL approach  
Credit Unions were required to comply with IFRS 9 from January 1, 2018. IFRS 9 used the Expected Credit Losses (ECL) model which is a forward-looking approach to the estimation of impairment losses.
- 5) Implementation of IFRS 9  
Some credit unions have implemented IFRS 9, however, we note the challenges of the unavailability of data/models to derive quantitative parameters. AQR will assess the models used by the credit unions that have implemented IFRS 9.

Credit Unions will be informed under separate cover of their placement for the Asset Quality Review. On completion of the Asset Quality Review (AQR) the FSRA will be in a better position to carry out its regulatory and supervisory function of credit unions.

Please be guided accordingly.

Yours sincerely

A handwritten signature in blue ink, consisting of several loops and a long horizontal stroke at the bottom.

**Nathalie Dusauzay**  
**Executive Director**