Global Regulatory Update

(For Credit Unions and Financial Cooperatives)

World Council of Credit Unions
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World Council

Introduction

Welcome to the 2021 Edition of the World Council of Credit Unions' Global Regulatory Update. This edition will cover the leading regulatory issues affecting credit unions in 2021. In the wake of the COVID-19 pandemic, digital innovation, political transformations and a heightened focus on environmental issues, certain topics within the financial services arena have revealed deficits and the steps necessary to improve the playing field.

This year we are settling into the banking regulatory relief measures initiated to address persisting complications stemming from the pandemic. International Advocacy will focus on how regulators react to the institutional stress placed on credit unions and how they will engage in an orderly withdrawal of those relief measures.

Credit unions have benefited from the enhancement of flexible regulations. However, this pandemic has underscored the need to digitize their services. With more consumers working and living at home, access to financial services is better served remotely. Many credit unions are reassessing their current technological capabilities in light of the current conditions.

Sustainable finance has picked up traction as environmental concerns, including COVID-19, continue to persist. Harmonizing financial sustainability reporting, creating a sustainable economy and supporting sustainable investments to fight those threats to our ecosystem which lead to future pandemics are priorities that international setting bodies hope to address.

The all-encompassing discussion of proportionality, as well as issues related to AML/CFT and payments will continue to dominate 2021. Additionally, underlying concerns regarding cybersecurity and privacy will remain an undercurrent to all trending financial services' topics.

World Council of Credit Unions' International Advocacy Department continuously engages with international standard setting bodies—incurring successes in reducing regulatory burdens for credit unions in many areas, such as prudential regulation, anti-money laundering, taxation and accounting standards. World Council's priority is to improve the regulatory operating environment for credit unions in a safe and sound manner. World Council engages in advocacy, development and education to champion and grow credit unions and cooperative finance worldwide. There are over 86,000 credit unions in 118 countries with USD 2.6 trillion in total assets serving 291 million members.[1]

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[1] World Council of Credit Unions, *2019 Statistical Report* , *available at* https://www.woccu.org/documents/2019_Statistical_Report.

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Proportionality

In last year's Global Regulatory Update, we made the statement that proportionality would likely be the biggest topic in 2020 and for many years to come. This proclamation remains true for 2021. World Council continues to advocate for the simplification of rules for smaller, less complex and less risky financial institutions; or in other terms, the tailoring of rules to reflect the size, risk profile and complexity of the financial institution. Standard setting bodies are beginning to value the need for proportional guidelines, recommendations and regulations. Proportionality not only allows smaller institutions to remain viable and effective, but it also promotes financial inclusion. Financial cooperatives such as credit unions have the ability to provide much needed services to the underserved and underbanked communities. Those communities have grown since the outset of the pandemic and have further highlighted the need for regulations that will support those most in need of financial help. Credit unions have proven themselves to be COVID-19 financial first responders. However, regulatory burden that is overwhelmingly cost prohibitive can quickly prevent them from providing these essential services.

Key Events in Proportionality

The Basel Committee on Banking Supervision issued an updated version of its guidelines on *Sound management of risks related to money laundering and financing of terrorism*, with guides on the interaction and cooperation between prudential, and anti-money laundering and combatting the financing of terrorism (AML/CFT) supervisors. The issuance specifically included World Council-recommended language stating that AML/CFT burdens should be "proportional and risk-based, informed by banks' own risk assessment of ML/FT risks." Further, with respect to member/customer due diligence, the guidance notes that "It is important that the customer acceptance policy is not so restrictive that it results in a denial of access by the general public to banking services, especially for people who are financially or socially disadvantaged."

It is a key policy priority of World Council to safeguard financially underserved populations' access to the fundamental services necessary to participate in today's financial market.

World Council suggested the Financial Action Task Force (FATF) adopt amendments to Recommendations 1 and 2 and their Interpretive Notes that urge clear direction to national-level regulators to tailor proliferation-financing regulations proportionately for credit unions. The amendments require countries and the private sector to identify and assess the risks of potential breaches, non-implementation or evasion of the targeted financial sanctions related to proliferation financing, as contained in FATF Recommendation 7, and to take action to mitigate these risks and enhance domestic coordination.

FATF responded to World Council's request by encouraging countries to implement the new requirements in a manner that is consistent with these objectives and apply measures proportionate to the risk of the relevant institutions. FATF further reiterated its strong support of financial inclusion goals. Ensuring access to regulated financial or non-financial services, without compromising the measures that exist for the purpose of AML/CFT/CPF, is a key policy priority of World Council.

The International Association of Deposit Insurers (IADI) published their Guidance Paper, 'Risk Management and Internal Control System of Deposit Insurers' that included World Council-advocated Guidance Points to address risk management in Deposit Insurers (DIs). Most notably, the Paper included Guidance Points based on the principle of proportionality and additionally provided suggestions for minimum requirements more appropriate for smaller DIs.

What this means for credit unions

International regulators are beginning to adopt proportionality routinely in their standards. While this may relieve credit unions from overly burdensome regulations, they still need national-level regulators to get on board. National-level regulators continue to apply the strictest standards designed to regulate global systemically important banks (G-SIBs) on small financial institutions. World Council will continue to advocate on behalf of financial cooperatives by requesting that international standard setting bodies provide clear and definitive guidance and permission to national-level regulators to use proportional application of their guidance and regulations.

Key Documents

Sound management of risks related to money laundering and financing of terrorism: Bank for International Settlements' revised guidelines for including ML/FT within an institution's overall risk management methodology suggested the use of proportionality and risk-based assessments.

International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, the FATF Recommendations: These updated recommendations strengthened requirements for higher risk institutions and enhanced areas of high risk, and notably included language incorporating proportionality.

The Bottom Line

Proportionality is an opportunity for prudential regulators and international standard-setting bodies to not only give smaller financial institutions equitable footing under prescribed guidelines, regulations and other requirements, but to support financial inclusion by ensuring that regulations are "right-sized" for credit unions such that essential financial services are not denied to the general public, especially those that are financially or socially disadvantaged.

Anti-Money Laundering and Combating the Financing of Terrorism

The COVID-19 pandemic has highlighted new and emerging threats, as well as challenges to preventing AML/CFT risks. Criminals are finding innovative ways of exploiting vulnerabilities. Some of these criminal schemes include fraudulent acts, such as the impersonation of officials and counterfeiting; impersonating government and hospital officials and asking victims for cash; and a rise in scams to acquire or sell counterfeit personal protective equipment (PPE), medical supplies and medicine—including advanced payment scams to sell medical equipment. Cyber criminals are creating malicious internet links and attachments revealing usernames and passwords; exploiting vulnerable groups of workers and producing victims of human trafficking; granting fake loans; and intercepting disbursements sent through the banking system to countries and/or disbursements misused by government officials.

2021 AML/CFT Outlook

The Financial Action Task Force (FATF) has asserted that during this current pandemic, international and domestic cooperation is key, as well as the need for impactful policy decisions, including a coordination mechanism to respond to crises and coordinate with supervisors. FATF also suggested their proactive engagement with the private sector to set clear expectations, provide a contact point for recording entities and keep comprehensive records.

In 2021, World Council anticipates that FATF will continue to provide a flexible, risk-based approach to its regulations, as well as continued focus on the cooperation and information exchange between competent authorities responsible for supervising credit and financial institutions. FATF will focus on facilitating more effective supervision at the national level.

Most notable for credit unions is FATF's commitment to financial inclusion through pertinent restrictions on services in order to reduce risk, i.e. transaction limits, continuing to monitor accounts so risks do not change over time, simplified due diligence for some jurisdictions, FAQs and indicators for CFT risks, and non-profit guidance as they carry low or no CFT risks. World Council looks forward to continued improvements to FATF's approach to regulation and supervision in a way that supports its goal for financial inclusion. Proportionality will be essential to accomplishing this goal.

FATF will most likely continue to focus on electronic and digital payment options, digital assets and digital identity—such as facial recognition. Terrorist financing risks of virtual assets will also be a priority. Fintech has become a dominating feature in financial services, prompting new and innovative AML/CFT cybersecurity risks. Expect FATF to focus on further strengthening the global network to harness the potential of technology for the digital transformation of AML/CFT. Finally, ensuring transparency of beneficial ownership of legal entities will likely remain an objective in the coming year.

Key Documents

[Guidance on Digital Identity]: The Guidance outlines how systems can be used to conduct certain elements of customer due diligence (CDD) under FATF Recommendation 10 and highlights ways in which digital ID systems for CDD can support financial inclusion.

International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, the FATF Recommendations: These updated recommendations strengthened requirements for higher risk institutions and enhance areas of high risk, and notably included language incorporating proportionality.

COVID-19-related Money Laundering and Terrorist Financing Risks and Policy Responses: FATF's response to the impact of COVID-19, global AML and CFT efforts, and the application of the FATF Standards during the current pandemic.

The Bottom Line

AML/CFT requirements continue to evolve in light of technological advances and the onset of the COVID-19 pandemic. FATF will face challenges in adjusting and creating more malleable requirements in order to effectively improve AML/CFT counter measures while allowing financial entities the flexibility to maintain resources. World Council will work to ensure that FATF standards continue to incorporate a risk-based, flexible and proportional approach that allows credit unions to perform their AML/CFT responsibilities without driving them out of the market.

Sustainable Finance

In our 2020 Global Regulatory Update, World Council discussed ongoing environmental initiatives to combat climate change and other threats to our ecosystems, such as sustainable investing through blended finance, capital markets funding for climate change adaptation, affordable housing, clean water, and other private investment strategies aimed at raising capital for sustainable projects. Today, COVID-19 has proven itself to be one of the most imminent threats to our environment, exposing the need for swift recovery action and regulatory reform.

Sustainable finance in 2021 will most likely take shape in the form of defining, improving and harmonizing sustainability reporting, as well as addressing topics around renewed sustainable finance strategy. With the European Commission's 2019 adoption of its Communication on a European Green Deal, the Commission is looking to expand the "EU's climate action and environmental policy ambitions," especially considering COVID-19 challenges. This pandemic has made it imperative "to address the multiple and often interacting threats to ecosystems and wildlife to buffer against the risk of future pandemics, as well as preserve and enhance their role as carbon sinks and in climate adaptation."[1]

Credit unions are in a unique position to contribute to a sustainable society. Many of the members they serve are immersed in the sustainability and improvement of their environments. Agricultural lending, small and medium-sized enterprises (SMEs), and other small business loans have been integral to supporting environmental improvements. It is imperative that prudential regulators and national-level regulators are aware of the benefits cooperatives provide to their sustainable goals and support them with proportional methods of supervision and regulation.

Areas where there will likely be developments include corporate governance requirements (i.e. how you will include sustainability goals in your strategic planning), greater disclosures and costs in connection with various products (i.e. green mortgages, green loans), and greater requirements on investments.

While many of the climate-related goals are laudable and supported by most, how they filter into prudential regulation can be quite tricky and complex and may result in unintended consequences. Therefore, our advocacy efforts will focus on how these measures are translated to the national level, realizing there may be a significant role for credit unions to play.

Key Documents

European Green Deal: European Commission's growth strategy to make the European Union's economy sustainable.

EU taxonomy for sustainable activities: EU classification system for sustainable activities.

Action Plan: Financing Sustainable Growth: European Commission's strategy to incorporate finance with sustainability. Adopted 2018.

Guide for Supervisors: integrating climate-related and environmental risks into prudential supervision: Network for Greening the Financial System, Technical Document (May 2020)

The Bottom Line

The integration of global (and national) sustainability goals into the financial regulatory framework is in the early stages. World Council will seek to ensure that this complex undertaking helps to support the credit union role in addressing climate change, while ensuring the regulatory framework does not adversely impact the ability of credit unions to serve its members.

[1] See, *Consultation on the Renewed Sustainable Finance Strategy*, available at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2020-sustainable-finance-strategy-consultation-document_en.pdf.

Payments

The G20 has made the enhancement of cross-border payments a priority during the Saudi Arabian Presidency. The members of the G20 supported developing faster, cheaper, more transparent and more inclusive cross-border payment services, including remittances, while maintaining their safety and security. Their goal is to achieve widespread benefits for citizens and economies worldwide, supporting economic growth, international trade, global development and financial inclusion. This inherently means significant changes to existing payment infrastructures. Their roadmap focused on action steps that included:

- Committing to a joint public and private sector vision to enhance cross-border payments.
- Coordinating on regulatory, supervisory and oversight frameworks.
- Improving existing payment infrastructures and arrangements to support the requirements of the cross-border payments market.
- Increasing data quality and straight-through processing by enhancing data and market practices.
- Exploring the potential role of new payment infrastructures and arrangements.

The European Union is also quickly moving for reforms in the payments space. According to the European Commission, "…payments have become strategically significant. They are the lifeblood of the European economy." In a communication to Parliament in December 2018, the Commission supported "a fully integrated instant payment system in the EU, to reduce the risks and the vulnerabilities in retail payment systems and to increase the autonomy of existing payment solutions."[2] Innovation and digitization of payments have prompted the Commission to adopt a Retail Payments Strategy for the EU (RPS). The RPS, which received input from the Commission's Digital Finance Strategy, aims to strengthen the EU's influence and consolidate its economic autonomy with safe and efficient payment systems and improve its ability to deal with emergencies, such as the current pandemic.

The RPS focuses on four key pillars:

1) increasingly digital and instant payment solutions with pan-European reach;

2) innovative and competitive retail payments markets;

3) efficient and interoperable retail payment systems and other support infrastructures; and

4) efficient international payments, including remittances.

The Commission maintains that "…implementing this strategy will contribute to the Commission's broader vision for digital finance and to its objectives of: removing market fragmentation,

[2] See, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on a Retail Payments Strategy for the EU* (September 2020), available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020DC0592.

promoting market driven innovation in finance and addressing new challenges and risks associated with digital finance whilst ensuring technology neutrality."[3]

World Council expects to see changes on the horizon surrounding consumer protection, mandates for instant payments (which could be a large compliance/regulatory burden), potential disruption from non-bank providers who will have easier access to the market, potential changes to privacy frameworks allowing for open banking (access to customer/member data), as well as other regulatory and operational changes.

Key Documents

Enhancing Cross-border Payments, Stage 3 Roadmap, Financial Stability Board (October 2020).

Digital Finance Package: September 4, 2020 Communication on Financial Stability, Financial Services and Capital Markets Union. The Commission adopts package to support innovative financial products, and to set rules on crypto-assets and digital resilience.

Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on a Retail Payments Strategy for the EU: European Commission's Strategy to adopt common schemes and rules to address changing payments instruments and digital innovation.

The Bottom Line

Significant changes in the payments framework will bring regulatory and compliance challenges for credit unions. Further, the potential for disruption in the marketplace is high. In particular, those credit unions that have not achieved high levels of digitization will face significant disadvantages. World Council will continue to advocate for a fair, level playing field for smaller financial institutions such as credit unions and other financial cooperatives, and ensure that any compliance burdens are proportional.

COVID-19 Recovery

In 2020, many standard setting bodies organized policy responses to support swift and effective implementation of measures to respond to COVID-19 challenges. World Council called for relief measures early on in the pandemic and most regulators responded with unprecedented action to

[3] Id.

mitigate the effects of COVID-19 on the financial sector. Credit unions faced unique challenges worldwide, such as being declared as "essential" and obtaining the ability to conduct meetings virtually. Many of these relief measures were made available quickly for the banking sector but were slower to arrive for credit unions.

As the relief measures begin to end, the concern over economic shock and slowdown is potentially looming. An increase in non-performing loans could reach record highs. The effect on capitalization and the challenges to asset quality are likely on the minds of regulators. The timing of the termination of national moratoria measures and loan guarantees will exacerbate the concerns as well. Expect regulators to take proactive approaches to managing these issues.

World Council will be actively engaged with many of the regulators to ensure an orderly withdrawal of the relief measures and that appropriate remedial measures are provided for credit unions. In particular, any solutions that are designed to deal with non-performing loans should include access by credit unions, as we know market-based solutions can often provide helpful relief. This also requires proper and prudent credit risk management by credit unions and we expect regulators to pay close attention to these items. Proper provisioning likewise will be a focus. Credit unions are member owned and are often in a better position to distinguish between viable borrowers and distressed borrowers. We will ensure this difference is considered in regulatory approaches.

Key Documents

Advocacy Insights: Advancing the Credit Union Cause During a Global Pandemic, World Council of Credit Unions (May 2020).

Credit Union COVID-19 Guide to Regulator and Operational Responses, World Council of Credit Unions (May 2020).

The Bottom Line

World Council urges regulators to consider the credit union difference during the various stages of COVID-19 recovery:

1. When engaging in the withdrawal of COVID-19 relief measures;
2. in allowing credit unions to be the financial first-responders to help citizens through the pandemic; and
3. when applying remedial measures such that credit unions can emerge as viable financial contributors to society.

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Digitization

Credit unions should pay special attention to the advancements and pertinent regulations related to digitization. Innovation in digital finance, fintech, reg tech, etc. is constantly evolving and improving. This is an area of financial services that will increasingly become a top priority across all standard setting bodies and analogous to all finance categories. Regulators will have to quickly enhance their supervisory, regulatory and enforcement systems to keep up with the ever-changing landscape of digital finance. Many credit unions have yet to implement viable digital or technology programs. However, it is imperative they start strategizing on how they will initiate digital solutions or they will quickly fall behind regulatory requirements and fail to adequately provide access to much-needed services for their members. This could have huge financial inclusion implications, as well as overall market ramifications.

World Council is aware that the increased use of digital finance generates concern that regulation will become burdensome and costly for financial cooperatives. World Council will continue to inform regulators of the challenges cooperatives face when implementing and monitoring new financial technology.

The Bottom Line

Credit unions will eventually need to innovate and upgrade their financial services not only to meet the demand for digital services, but to support financial inclusion. Accessible finance is essential to credit union customers and digitizing is essential to reach as many members as possible.