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Global Regulatory Update

(For Credit Unions and Financial Cooperatives)

World Council of Credit Unions
2022 Edition

Andrew T. Price, Esq.
Senior Vice President of Advocacy
and General Counsel
World Council of Credit Unions
European Network of Credit Unions
aprice@woccu.org

Panya N. Monford, Esq.
Assistant General Counsel of
Advocacy
World Council of Credit Unions
European Network of Credit Unions
pmonford@woccu.org

Introduction

Welcome to the 2022 Edition of the World Council of Credit Unions' Global Regulatory Update. This edition will cover the leading regulatory issues affecting credit unions this year. As the COVID-19 pandemic lingers and continues to impact our lives, a multitude of challenges to financial regulation continue to make their debut with prominence. Solutions to many of the existing concerns are currently under construction, and the coming year will bring further consideration and some conclusions to persisting matters, as well as introductions to new and evolving matters.

For many of us, 2022 will be a year of repair and reboot, and the regulatory landscape is no exemption. That landscape will not only include historical issues that typically encircle the financial services industry, but social and environmental issues we are discovering to be elemental to the survival of all aspects of our future. Credit unions have been vital to many aspects of sustainability. Many of the communities they serve include industries that are inherent to the environments they provide for. Financing for small and mid-sized enterprises (SME's), and macro and nano loans have provided many businesses, such as agriculture, women-owned, and affordable and green housing ventures, with the means to provide for their communities while keeping their physical environments and their businesses sustainable. Credit unions are synonymous with the pursuit of sustainable growth.

Financial inclusion remains a significant aim of many of the leading regulators and policy makers. We are noticing a change in regulatory reforms that are not only broaching the importance of financial inclusion but are actually implementing policies that are effective in supporting it. Once again, credit unions and cooperatives have been ahead of the curve. Financial inclusion is the foundation, mission, and impetus for our credit unions' existence. CUs give those that are underserved, underbanked and underrepresented the opportunity to make their mark on the planet—a mark that can be seen from space, but not usually within the space in which they live.

This year's regulatory update will once again include themes on proportionality, sustainable finance, AML/CFT issues, payments and digital finance. However, we will also move with the regulatory waves that are currently flowing in the direction of social change and give more credence to the importance of financial inclusion and how credit unions have always been a constant and substantial contributor to social change and progress.

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 3.2 trillion in total assets serving 375 million members.[1]

[1] World Council of Credit Unions, *2020 Statistical Report , available at* https://www.woccu.org/documents/2020_Statistical_Report.

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Sustainable Finance

Sustainable Finance is a broad term representing discussions around numerous topics, all of which are quite complex, interconnected and evolving rapidly. Much of the discussion centers around environmental, social and governance factors and how these considerations will affect both prudential, governance and conduct regulations. How these policy changes will ultimately affect credit unions, however, has not yet been deciphered. The G20, in its most recent Leaders' Declaration, focused heavily on this issue, mainly around coordinating efforts to mitigate the effects of climate change and helping countries meet their obligations surrounding the Paris Agreement Accords. They are particularly concerned about the impacts of climate change that are experienced worldwide particularly by the poorest and most vulnerable populations.

To that end, the Finance Ministers and Central Bank Governors have reached an agreement to coordinate their efforts to tackle global challenges, such as climate change and environmental protection, and to promote transitions towards green, more prosperous and inclusive economies. The G20 has established the G20 Sustainable Finance Working Group and endorsed the *G20 Sustainable Finance Roadmap and the Synthesis Report*. The Financial Stability Board (FSB) has adopted its *Roadmap for Addressing Climate-Related Financial Risks* in an effort to coordinate the large and growing number of international initiatives underway that address financial risks from climate change. The International Financial Reporting Standards Foundation is working to develop baseline global reporting standards and has established the International Sustainability Standards Board (ISSB) to develop global standards to improve the consistency, comparability and reliability of sustainability reporting. The Basel Committee on Banking Supervision is currently working on revisions to the Basel Framework to promote a common disclosure baseline for climate-related financial risks across internationally active banks. This is in addition to the Basel Committee's larger holistic approach that looks to address the range of climate-related financial risks to the banking system spanning across regulatory, supervisory and disclosure-related matters.

Credit unions will likely witness a modification to regulations affecting numerous areas of financial services. Presumably, there will be an onset of regulations encouraging or requiring investments of assets in environmentally responsible financial products and engagement in investment practices that are environmentally friendly. The Bank for International Settlements (BIS) is already issuing green bonds for investments by central banks from around the world. Products issued by credit unions that are labeled "green" or "sustainable" will likely see additional regulations, i.e., "ecolabels."[1] The criteria for these products or these types of labels will be of significant discussion. Governance/prudential regulations related to sustainable finance may require everything from disclosures and reporting requirements to regulations on how a

[1] According to the Environmental Protection Agency: "Ecolabels are marks placed on product packaging or in e-catalogs that can help consumers and institutional purchasers quickly and easily identify those products that meet specific environmental performance criteria and are therefore deemed "environmentally preferable"." See, https://www.epa.gov/greenerproducts/introduction-ecolabels-and-standards-greener-products#ecolabel.

credit union runs and operates its physical locations. Requirements for boards of directors are likely under consideration as well.

The good news for credit unions, however, is that part of the scope of sustainable finance initiatives is to expand consideration of social issues such as financial inclusion. Credit unions, as community-based financial institutions that invest in local communities, are well positioned to be recognized for the social benefits that arise from the credit union cooperative model. As discussions continue regarding the effect of social issues on environmental concerns, as well as the development of social taxonomies, credit unions will undoubtedly hold a strong position as one of the bastions of social advancement in these areas.

The Bottom Line

Sustainable Finance will transform the regulatory landscape for credit unions on many fronts, including investments, governance, disclosures, reporting and products. Credit unions are well positioned to demonstrate their value within social considerations given their unique model which supports local communities.

Key Documents

G20 Sustainable Finance Roadmap and the Synthesis Report

FSB Roadmap for Addressing Climate-Related Financial Risks

G20/Financial Inclusion/Proportionality

Proportionality continues to be a priority for World Council and is necessary for the tailoring of regulations to the size, risk and complexity of the institution. Rules should be adopted that reflect the unique nature of the credit union cooperative model. They need to reflect the systemic importance, the cross-border activity (or lack thereof) and, more generally, the risks to which they are exposed. We know that the failure of national-level regulators to use proportionality, which is inherent in most international standards, can lead to or compound financial exclusion. Financial exclusion is an important and complex issue that must be addressed. Marginalized groups are not able to or have difficulty accessing responsible and affordable financial services from a regulated provider. The issues surrounding financial exclusion include, but are not limited to, poverty, cost of accounts, limited access to digital infrastructure, trust and privacy concerns. Credit unions, however, as not-for-profit, member-owned, community-based cooperative institutions, are well positioned to overcome these obstacles. Unfortunately, regulatory frameworks often prove to be disproportionate and unnecessarily burdensome, preventing a credit union from serving marginalized groups. Proportionality is the key to overcoming this hurdle.

While many of the international standard setting bodies have embraced proportionality, national-level regulators are still reticent to tailor international norms and standards for fear that deviation may subject them to criticism from other nations or fear of an unintended consequence as a result of right-sizing regulations. Further, the lack of international guidance on proportionality is, in part, a contributor to this disparate treatment. To remedy this situation and to assist in advancing financial inclusion, it is imperative for national-level regulators to work in connection with the international standard setting bodies to fully adopt proportional tailoring of regulations. Therefore, in 2022, World Council will continue to focus on increasing the dialogue between the international standard setters and national-level regulators.

Fortunately, international standards setters, in part due to World Council and its members' efforts, are targeting this issue. They realize that regulations that do not effectively support institutions like credit unions conflict with their goals to improve financial inclusion and other important social issues. The G20 in 2021, under the direction of the Italian Presidency, reaffirmed is support for proportionality and financial inclusion. They endorsed a menu of policy options focused on digital financial literacy and financial consumer protection aimed at promoting financial inclusion. They released the G20 2020 Financial Inclusion Action plan, which includes a provision calling for an enabling and proportionate legal and regulatory framework for digital financial inclusion.

This is important because the international standard setters such as the Basel Committee, the Financial Action Task Force (FATF) and others take their direction from the G20. They have responded in various forms and are now focused on working with national-level regulators on proportionality. FATF published its *High-Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards*, which included language in the report stating that "[i]n general, the misapplication of the FATF Standards, and in particular the failure to use the proportionality that is central to the risk-based approach, can lead to or compound financial exclusion." They also noted the problem of de-risking can negatively affect credit unions when offering access to affordable and necessary financial services. The Basel Committee likewise continues to include proportionality in their finalized guidance, notably in its recent guidance on operational resilience[2].

This year, the G20 will be led by the Indonesian Presidency. It will work within the Global Partnership for Financial Inclusion (GPFI) established by the G20 to advance financial inclusion initiatives globally as a means of increasing well-being and achieving sustainable and inclusive growth. The focus of the GPFI is to enhance the access to, and the use of, responsible formal financial services – also through digital means – for families and businesses.

World Council will work with this group to continue understanding the connection between proportionality and financial inclusion and, more importantly, the significant role that credit unions can play in achieving this goal.

The Bottom Line

The focus on proportionality by the G20 and international standards will ultimately lead to reduced regulatory burden and regulatory frameworks that enable a credit union to maximize its potential. This ultimately will help address concerns related to financial exclusion.

[2] See, Principles for Operational Resilience at: https://www.bis.org/bcbs/publ/d516.pdf.

Key Documents

[G20 Leaders' Declaration – Rome]

[FATF High-Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards]

Anti-Money Laundering and Combating the Financing of Terrorism

Anti-Money Laundering/Counter-Terrorist Financing (AML/CFT) requirements continue to be one of the largest sources of regulatory burden for credit unions. Compliance with the requirements not only directly affects operations from account opening to monitoring transactions, it also affects the ability of a credit union to successfully interact in the financial services industry. This is evident by the number of correspondent banking relationships that in 2021 continued to decrease by 4% from the previous year, representing a 25% total decrease between 2011 and 2020. Much of this is driven in part by AML/CFT requirements. FATF is keenly aware of this issue and has done a tremendous amount of work to reverse this trend. Almost all the standards and guidance released by FATF embrace a risk-based approach and support proportionality. FATF has been explicit that regulatory burden should not be excessive to the point of excluding access to those in need of financial services, particularly those most in need of financial inclusion.

FATF is now taking the additional step of examining the unintended consequences of its standards, issuing the *High-Level Synopsis of the Stocktake of the Unintended Consequences* to examine and mitigate "de-risking and financial exclusion, as well as ensuring that countries' measures to protect NPOs from terrorist financing abuse are focused and proportionate."

This is significant as FATF is using this approach to bolster the development of revisions and new regulatory standards. This is a full embrace of acknowledging the need for proportionality as it relates to AML/CFT standards. World Council will maintain its efforts to ensure that this important work continues.

Notwithstanding the foregoing, the AML/CFT landscape is ever changing, and the complexity of regulations continues to increase. FATF is working on addressing numerous evolving issues, including:

a. **Beneficial Ownership of Legal Entities:** FATF continues to improve beneficial ownership transparency. Oftentimes legal entities are manipulated in a way to launder billions of dollars through fake companies with the proceeds being used for illicit crimes. Expect continued regulatory efforts on this issue over the next several years.
b. **Environmental Crime:** FATF has been focusing on illegal trade in wildlife, forestry crime, illegal mining and waste trafficking, noting that these crimes generate hundreds of billions annually and are destroying the environment, creating health and financial costs, and exacerbating climate change. Illegal logging alone last year generated up to USD 152

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billion in revenue. Countries that are rich with domestic natural resources should expect a focus on these issues from their regulator.

c. **Ethnically or Racially Motivated Terrorism:** FATF published a report on the funding behind Ethnically or Racially Motivated Terrorism Financing[3]. The report identifies common structural characteristics and patterns, and notes that most extreme right-wing groups obtain funding from legal sources, such as donations, membership fees and commercial activities. The increase in ethnically or racially motivated terrorist attacks in recent years tragically highlights the importance of raising awareness and improving understanding in the international community of financial flows and cross-border linkages between these terrorist groups and individuals. FATF is encouraging nations to identify these groups and increase awareness among regulated entities. Expect more concentration on this issue and corresponding AML/CFT responsibilities in the future.
d. **Use of Art and Antiquities to Launder Money:** FATF estimates that of the approximate USD 67.4 billion global art market, as much as USD 6.3 billion are linked to some form of transnational crime. Money laundering and other financial crimes account for approximately USD 3 billion. The art market presents ideal properties that make it attractive to launder proceeds of art related crime. As such, FATF is working on a project to help countries, competent authorities and the private sector better understand how criminals and terrorists can abuse trade in art, antiquities and cultural property, and develop best practices and recommendations to mitigate these risks. Expect further guidance and reports from FATF on this issue.
e. **Virtual Assets:** FATF published a second report on red flag indicators to help financial institutions detect and report suspicious transactions associated with virtual assets. The potential benefits include making payments faster and cheaper; but the anonymity associated with virtual assets attracts criminals, who have used virtual assets to launder proceeds from a range of offenses, such as the drug trade, illegal arms smuggling, fraud, tax evasion, cyberattacks, sanctions, evasion, child exploitation and human trafficking. FATF does appreciate that virtual assets can also be used as a great benefit for purposes of faster and cheaper payments. Balancing these two interests will be a focal point for FATF.
f. **Proliferation Financing:** FATF finalized revisions to its standards that require countries and the private sector to identify and assess the risks of potential breaches and non-implementation or evasion of the targeted financial sanctions related to proliferation financing. The new requirements seek to ensure that financial institutions are aware of the risks involved in their businesses and professions, and do not unwittingly support or become part of the proliferation financing networks or schemes. The revised standards require countries and the private sector to allocate appropriate resources to their counter proliferation financing efforts that are in line with the level of risks they encounter.
g. **Digitization/Digital Identity**: FATF is keenly aware of technological changes occurring in the industry and is studying the adoption of different digital tools to assist AML/CFT efforts. There have been a series of projects to take stock of the landscape, opportunities

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[3] See, Ethnically or Racially Motivated Terrorism Financing at: https://www.fatf-gafi.org/media/fatf/documents/reports/Ethnically-or-racially-motivated-terrorism-financing.pdf.

and challenges of digital adoption across the world. FATF aims to provide guidance to public and private sectors on harnessing the opportunities that technology can offer to enhance AML/CFT efficiency and effectiveness. A corollary to the ongoing digitization is the use of digital identity. FATF has provided guidance on the use of this technology by a financial institution, but the issue is intertwined in numerous evolving issues such as reforms to the payments systems and open banking/privacy issues. Expect digitization and digital identity to continue to undergo reforms.

The Bottom Line

FATF is keenly aware of the issues that impede progress to financial inclusion and the success of smaller financial institutions. AML/CFT regulations continue to represent significant compliance and regulatory burden challenges for credit unions. FATF is paying close attention to these challenges and is developing innovative solutions to address these challenges.

Key Documents

High-Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards

Payments

In 2021, the G20 in Italy continued its push to create faster, cheaper, more transparent and inclusive cross-border payments. The G20 supported the *G20 Roadmap for Enhancing Cross-Border Payments* and endorsed the global targets for addressing the challenges of cost, speed, transparency and access by 2027. This is significant, as 2022 will feature specific proposals for material improvements of underlying systems and arrangements, as well as the development of new systems. The work of the FSB and the Committee on Payments and Market Infrastructure (CPMI) in this area will be significant for shaping the payments landscape.

Over the past few decades, payment services have undergone radical transformations in light of the ongoing digitalization that is occurring worldwide. This acceleration has been greatly influenced by the onset of the COVID-19 pandemic. New payment methods and interfaces have taken shape and many more innovations are developing daily. Notwithstanding, cross-border payments are still, in many instances, slow, expensive, opaque and non-inclusive. The Roadmap is designed to address many of these concerns. 2022 will likely prove to be a transformative year in the payments arena where many of its principles can impact credit unions both in a positive manner and in a disruptive fashion.

Many of the policy issues currently under discussion are as follows:

- Faster Payments: Many countries have faster payments schemes adopted or in process. The EU is contemplating mandating the use of faster payments.
- Security/Validation/Compliance: Any changes will highlight issues of security (operational resilience) and the ability to validate transactions (which has open banking implications), as well as overall compliance challenges (i.e., the ability to check sanctions lists, etc.). All

of these changes can impact a credit union's operations and/or ability to enter into payments systems.

- API and ML: The use of these technologies is seeing a steep adoption and the overall impact of the payments industry is unclear.
- Digital Currencies: These have the ability to disrupt all of the payments systems.

The Bottom Line

Reforms in the payments sector may not only prove disruptive but may also provide opportunities for credit unions. Ensuring credit unions have access to payments systems in a manner that keeps them on a level playing field with other technology providers will be key.

Key Documents

G20 Roadmap for Enhancing Cross-Border Payments

Targets for addressing the four challenges of cross-border payments: Final report

Digitalization/Cybersecurity/Cryptocurrency

Digitalization is a broad word that encompasses all the technological changes occurring in the banking sector. The transformative nature of digitalization is vast and the need for digitalization has been greatly exacerbated by the COVID-19 pandemic, such as the necessity for remote work capabilities. Digitalization affects every aspect of our industry from the front end, retail side to the back end and operational aspects of a credit union. The G20 recognizes the importance of policies that relate to digitalization that are enabling, inclusive, open, fair and non-discriminatory. They are encouraging the application of new technologies, allowing businesses and entrepreneurs to thrive, and, most importantly, empower and protect consumers. Credit unions are aligned with these priorities, but the challenges with the implementation of technology are numerous. Privacy, data protection, security and intellectual property rights are all components that require policy changes associated with digitalization. These changes will bring more regulation and increased operational costs.

Under the umbrella term of digitalization, we are seeing many policy changes in the areas of operational resilience or cybersecurity that are garnering attention from regulators. The ability to absorb operational risk related events such as pandemics, cyber incidents, technology failures and natural disasters has the attention of all regulators. The Basel Committee issued two guidance documents on operational resilience, including the *Principles of Operational Resilience* and *Revisions to the Principles for the Sound Management of Operational Risk*, all calling for increased attention to gaps in operational risks associated with technology. The EU is close to adopting its Digital Operational Resilience Act (DORA), that will provide comprehensive standards for the financial sector. As technology changes, these requirements are likely to receive close attention by regulatory authorities as the ever-changing technology domain creates additional risks to the financial sector.

Hedging against significant operational failures or wide-scale disruptions in financial markets will be a focal point. World Council will again intensify its efforts on proportionality and continue to request regulations that are reasonable given the size, risk and complexity (or lack of complexity) of credit unions and cooperatives.

Also under the umbrella of digitization is the development of cryptocurrencies or digital currencies. The G20 reiterated that no so-called "global stablecoins" should commence operation until all relevant legal, regulatory and oversight requirements are adequately addressed through appropriate design and by adhering to applicable standards. They encouraged jurisdictions to progress in the implementation of the FSB's High-Level Recommendations and for standard setting bodies to complete their assessment of whether to make adjustments to standards or guidance in light of the FSB recommendations. The role of digital currencies in enhancing cross-border payments and their implications on the financial monetary system is under study by the CPMI, BIS Innovation Hub, International Monetary Fund (IMF) and the World Bank.

The issue of whether digital currencies should rely on a central authority or a decentralized governance system is of great debate. Whether access should be based on verification of identity or purely on cryptography are key questions that need to be answered. We will likely see a push for central banks to be the issuers and should grant access based on identification if digital currencies are needed. We have already seen various jurisdictions begin offering digital currencies or piloting various forms. Expect more developments in this area to occur.

Additional topics that deserve honorable mention for 2022 digital regulatory trends include:

- Environmental Social Governance (ESG): Criteria or standards related to social investments such as climate, diversity and equity, and sustainable product development.
- Privacy concerns for end users.
- Cybersecurity: Particularly surrounding cloud usage, which will also have privacy implications and other data usage issues.
- Real-Time Payments (RTPs): The necessity of Application Programing Interface (APIs) for most RTPs will require additional regulation to temper privacy and security concerns.
- Open Banking.

The Bottom Line

Digitalization is transforming the financial services landscape and will create regulatory and operational challenges. Evolving technological issues present both opportunities for credit unions as well as potential disruptive forces. While the current regulation may directly apply to financial institutions that are engaged in certain digital functions, it will be difficult to bifurcate regulation based on the haves and have nots.

Eventually, all financial institutions will need to implement basic digital functions in order to comply with emerging regulations.

Key Documents

Principles of Operational Resilience

Revisions to the Principles for the Sound Management of Operational Risk

BIS Digital Currencies and the Future of the Monetary System

FSB Regulation, Supervision and Oversight of “Global Stablecoin” Arrangements: Progress Report on the implementation of the FSB High-Level Recommendations