World Council

2023 Global Regulatory Update

(For Credit Unions and Financial Cooperatives)

Credit Unions as the Catalyst for Rebuilding

World Council of Credit Unions International Advocacy

Table of Contents

Introduction

Welcome to the 2023 Edition of the World Council of Credit Unions' Global Regulatory Update. This annual publication forecasts the leading global regulatory issues that will affect credit unions and financial cooperatives in the upcoming year. Regulatory burdens continue to impact operations and revenue, and therefore infringe on the cooperative model to maximize their services to their members. World Council's International Advocacy team will continue to monitor these regulatory issues throughout the year and implement strategic plans to support our advocacy efforts to tailor regulations appropriately and support the cooperative model.

The credit union cooperative structure is essential to the financial services market. The not-for-profit, member-owned, community-based structure centers credit unions' collective mission on its members and local communities, not on the interests of stockholders. This allows credit unions to prioritize its role as a member's best financial partner and to advance the communities they serve. It is well known that credit unions respond to crises and financial shocks differently than other types of financial institutions, such as banks, because of their unique, member-based governance structure. Throughout history, credit unions have provided a countercyclical liquidity buffer during times of crisis by increasing deposits and maintaining lending, despite financial shocks at both the community and national level. Banks tend to contract during times of crisis, causing people to seek the safety and security of credit unions as a trusted partner.

It is critical we continue to articulate this dynamic to policymakers so they understand the critical role credit unions can play during what promises to be a difficult year ahead. Even though the world hasn't completely escaped the throes of COVID-19, pandemic-era regulatory relief measures are being withdrawn, potentially leading to financial shocks. Economists are predicting a global recession, supply-chain disruptions are still prevalent and the conflict in Ukraine continues to have profound effects on the world economy.

Because credit unions are countercyclical and community based, they are the institutions on the ground, acting as financial first responders to many consumers. While governments manage important but larger macro-economic issues, credit unions aid citizens with their immediate financial needs, which are often overlooked or underserved by other financial institutions. Credit unions help consumers address financial concerns related to unemployment, inflation, even the inability to work due to COVID-19. They support existing SMEs and those that are reentering the market, thereby supporting the economy at the time that it needs it the most.

The importance of allowing credit unions to be this catalyst for rebuilding plays out most directly in regulatory frameworks through the issue of proportionality. Proportionality allows national-level regulators to tailor those rules that are often designed for large, internationally-active banks in a manner that permits local, community-based financial institutions to operate effectively. This encourages credit unions and other cooperative financial institutions to reach underserved markets and serve vulnerable populations.

This year, the link between proportionality and financial inclusion will be addressed by the G20 at the G20 Heads of State and Government Summit in Pragati Maidan, New Delhi. Sustainable finance has become an increasingly prevalent topic. Placing credit unions at the forefront as a contributor to social change and progress in addressing climate change and emphasizing our role in providing resilient and sustainable financial services will be a continuing priority. The social benefits of credit unions cannot be overlooked. Significant transformation is also occurring in payments, particularly related to cross-border payments and a focus on faster, cheaper, more transparent and more inclusive systems. Ensuring affordable and simple access for credit unions is an important objective. AML/CFT continues to impose large regulatory burdens for credit unions and often acts as a barrier to account opening and access to correspondent banks. Digitization, cybersecurity and the myriad of technological changes occurring also represent challenges in ensuring that the credit union cooperative model is considered.

The credit union cooperative structure matters. It is an effective model that brings value to our economic environment. Success in tailoring rules and regulations to support it will allow credit unions to be the catalyst for rebuilding the world economy. Understanding that if the policy of financial sector regulation truly aims for financial stability and efficiency, financial inclusion through the cooperative model will help achieve these aims, while also strengthening social and political stability.

I. THE G20 AND FINANCIAL INCLUSION

The Group of Twenty (G20) is the forum for international economic cooperation consisting of 19 countries and the European Union. It plays an important role in shaping and strengthening global architecture and governance on all major international economic issues. This is where the major leaders of the world come together with their respective finance ministers and central banks to take policy positions on various issues. Where there is consensus among the countries, they will reflect their positions in the Leaders' Declaration that is typically issued at the final summit. The Leaders' Declaration gives direction to many of the international standard setting bodies, such as the Basel

Committee on Banking Supervision, the Financial Action Task Force, the Financial Stability Board and others. Many of the same finance ministers and central banks that contribute to the G20 also participate in the governance of the international standard setting bodies.

There is also a finance track within the G20 process that includes the Global Partnership for Financial Inclusion (GPFI), which in 2023 will be co-chaired by both Italy and Russia. Focused on advancing financial inclusion globally, the GPFI works to improve financial system infrastructures, pursues policies conducive to harnessing emerging technologies, facilitates remittance flows and strives to reduce the cost of remittance transfers. The group also aims to boost consumer protections, traditional and digital financial literacy, and to bridge the digital divide.

During 2022, the Leaders' Declaration included an endorsement of the G20 Financial Inclusion Framework on Harnessing Digitalization to Increase Productivity and Foster a Sustainable and Inclusive Economy for Women, Youth and MSMEs, and the endorsement of the Yogyakarta Financial Inclusion Framework guided by the G20 2020 Financial Inclusion Action Plan. This is enormously important for credit unions, as these policy documents call for enabling and proportionate legal and regulatory frameworks. This endorsement of proportionality directs international standard setters to include proportionality in their frameworks, which will ultimately assist in convincing national-level regulators to tailor regulations for the size, risk and complexity of credit unions. The G20's recognition of the importance of proportionality has already resulted in favorable guidance on the issue. This year alone, the Basel Committee on Banking Supervision issued its High-level Considerations on Proportionality, with guidance on simpler, more easily understandable frameworks for smaller, less complex financial institutions, such as credit unions.

This connection between financial inclusion and proportionality is gaining understanding at the G20 level, as well as with the international standard setting bodies. This ultimately results in regulatory frameworks that support the member-owned cooperative structure of credit unions often overlooked when policymakers are making regulations designed for large, internationally-active banks.

This year, the G20 is being held in New Delhi, India, with a theme of "One Earth, One Family, One Future." India's G20 Presidency states that it is "striving for just and equitable growth for all in the world, as we navigate through these turbulent times, in a sustainable, holistic, responsible and inclusive manner." Financial Inclusion is again of importance to the Indian Presidency and will likely see support in the Leaders' Declaration. Connecting the dots between financial inclusion, proportionality and the important role credit unions and the cooperative model can play in being the catalyst for rebuilding will be a focus of WOCCU International Advocacy in 2023.

The Bottom Line:

The G20's endorsement of proportionality provided increasing support for the credit union cooperative model and allows credit unions to maximize their important role in providing affordable, responsible and inclusive financial services to underserved or marginalized populations.

Key Documents:

The G20 2020 Financial Inclusion Action Plan

The Yogyakarta Financial Inclusion Framework, which brings together the following documents:

- Implementation Guide of the G20 High-Level Principles on Digital Financial Inclusion;
- Digital and Innovative Financial Products and Services for MSMEs Beyond Credit Products;
- Regulatory Toolkit for MSMEs' Access to Digital Financial Services; and
- Progress on MSMEs Data Harmonization to create an implementable action plan to support digital financial inclusion.

II. SUSTAINABLE FINANCE/CLIMATE CHANGE

Sustainable finance and climate change have matured into ubiquitous themes with evolving meanings for different people in various sectors. Global efforts are underway to strengthen policies and mobilize financing from all sources in a predictable, adequate and timely manner to address climate change, biodiversity loss and environmental degradation, including significantly increasing support for developing countries. For the financial services sector, these changes will have broad and transformative implications.

Sustainable finance has been addressed from a diverse group of authorities that not only want to devote efforts to climate change-related issues, but also feel pressure from investors to create a transparent reporting system highlighting environmental risks that may affect their bottom line. The Paris Agreement on Climate change, also known as the Paris Accords, is an international treaty adopted by 196 Parties at the Paris Climate Conference (COP 21) in 2015. Many of the respective nations' obligations to address climate change arise from the Paris Agreement and the United Nations Framework Convention on Climate Change (UNFCCC), which was adopted with the goal of stabilizing greenhouse gas concentrations.

The G20 recently endorsed the 2022 G20 Sustainable Finance Report, which complements the Financial Stability Board's updated Roadmap for addressing climate-related financial risks, and the G20 Sustainable Finance Roadmap. The International Sustainability Standards Board (ISSB) is finalizing its standards to provide globally consistent, comparable and reliable climate-related financial disclosures. Beyond its work on climate-related matters, the ISSB aims to achieve interoperability across disclosure frameworks through a global baseline of sustainability-related disclosure standards.

The Basel Committee on Banking Supervision issued its principles and is continuing to work on all three pillars, including regulation, supervision and disclosures. The work accomplished by these groups indicates future changes all aspects of credit union operations, investments, governance and products, as well as services, supervision, disclosures, accounting and more. They will fundamentally transform how a credit union functions and operates. This will likely increase costs and impose additional compliance burdens for all financial institutions.

There is no doubt that governments and policymakers are taking various approaches to meet environmental, social and economic challenges for credit unions. Strong Environmental, Social and Governance (ESG) performance that requires a top-down commitment to the environment, community and other stakeholders is increasingly seen by regulators, investors and others as the key to the long-term objectives of any company, including credit unions. How credit unions are viewed, and how regulatory frameworks will be formulated, presents both challenges and opportunities. From a regulatory standpoint, creating proportional regulatory burdens that also allow the inherent benefits of the cooperative model to shine is the key balancing act.

There is ample opportunity to demonstrate the social benefits of credit unions with our community-based, member-focused model; however, developing a workable methodology to document that benefit will require access to quality data. The concern is that more data may be required by the new sustainable reporting requirements and could increase regulatory burden. This balancing act is well noted by the international standard setters, but the challenges in creating the frameworks are enormous.

The Bottom Line:

*A*ll aspects of a credit union's operations, including investments, governance, products and services, supervision, disclosures and accounting, are being transformed by developments in sustainable finance and climate change regulations. The implications all point to an increase in operational costs and deterred funds that are necessary to support credit union members. Posturing credit unions as sustainable, environmentally supportive financial institutions with unique benefits due to their cooperative model will be a focus of advocacy efforts, which could potentially alleviate some of the regulatory requirements and sustainability-related reporting disclosures.

Key Documents:

2022 G20 Sustainable Finance Report

Financial Stability Board: Roadmap for Addressing Climate-related Financial Risks

The Basel Committee on Banking Supervision: Principles for the Effective Management and Supervision of Climate-related Financial Risks

III. PAYMENTS

The payments landscape continues to evolve at a rapid pace with the emergence of new fintechs, technologies and regulatory challenges. Central banks are continuing to press ahead by issuing or experimenting with digital currencies. The G20 has set targets for faster, cheaper, more transparent and more inclusive cross-border payments. Instant payments have quickly become a dominant player in the payments game. While the world adapted to a pandemic with increased use of digital platforms, many credit unions have not had the resources to keep up with innovation.

More recently, the G20 supported the continued implementation of the G20 Roadmap for Enhancing Cross-Border Payments, asking for progress in meeting these key performance indicators and supporting the 2022 Progress Report that sets out priorities for the next stage of work related to payments. Additionally, the G20 encouraged central banks, other public authorities and the payments industry to continue to work collaboratively on these important initiatives to enhance cross-border payments.

In the European Union (EU), work continues on proposals to amend their PSD2 payments framework, with considerations of merging e-money and payments rules, along with other structural changes. A focus on consumer protection, access to payments systems and open finance are all under consideration. Notably, a proposal from the European Commission would mandate an EU-wide instant payments scheme requiring those who provide payments systems the ability to offer an instant payments solution for their member or customer.

Issues commonly associated with payments, such as digital identity, are under review in the EU and at the international standard setting level, with the Financial Action Task Force (FATF) recently issuing its Guidance on Digital Identity, which is intertwined with many payments issues from an anti-money laundering perspective. It also necessitates continuous work on virtual assets and their relationship with digital currencies. The EU also anticipates proposals on a jurisdiction-wide digital Euro, which will also have implications in the payments sector.

It is also worth noting proposals for the EU eIDAS framework that propose to offer a European digital identity wallet that would link EU citizens' national digital identities with other IDs, such as driver's licenses. This could have a significant impact for payment service providers, not only because it may affect compliance with high customer authentication standards, but also because it could open new opportunities for customer onboarding processes.

Around the world it is impossible to consider changes to the payments landscape without observing developments in cryptocurrencies, fintech, regulatory sandboxes, digital currencies, open finance, the metaverse and many other areas. Piecing these parts of the puzzle together and understanding the implications on the payments landscape will be an enormous challenge. Positioning credit unions as trusted providers and ensuring affordable access to the emerging systems on a level-playing field with other financial service participants will be key for credit unions.

The Bottom Line:

Significant changes are occurring in the payments area with potential disruptive effects on credit unions. Ensuring affordable access on a level playing field, so that credit unions can provide services to their members, will be key.

Key Documents:

G20 Roadmap for Enhancing Cross-Border Payments
2022 Progress Report for the G20 Roadmap for Enhancing Cross-Border Payments

IV. AML/CFT

Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) continues to be an emphasis for the G20, for international standard setting bodies like FATF) and for national-level regulators. It also continues to be one of the largest sources of compliance burdens for credit unions, presenting numerous obstacles for account openings and other services, such as payments. Credit unions acknowledge they play an important role in fulfilling their obligation to both monitor for and detect illicit activity. But these rules need to be appropriately tailored to smaller financial institutions, subject to a risk-based approach, and should adequately consider field of membership requirements and the cooperative model, which allow credit unions to have a unique relationship with their members as owners.

Unfortunately, AML/CFT regulations only continue to increase in number and complexity. It does not appear this trend will slow down in 2023. The G20 reaffirmed its guidance for the international community to step up their efforts to effectively combat money laundering, terrorism financing and proliferation financing. They have voiced their support for FATF's work plan and the FATF-style regional bodies who lead global action to respond to threats. The G20 also welcomed FATF's objective to promote the implementation of international standards on virtual assets, specifically the "travel rule" and transparency of beneficial ownership and acknowledged FATF's role in the fight against systemic corruption and environmental crimes, which gravely impact economies and societies. The G20 further encouraged all countries to strengthen collaboration in combating illicit crime, and to adopt and effectively implement the FATF standards.

The work to improve beneficial ownership of legal entities is ongoing and we should see the finalization of revisions to the standards this year. This is an area where, if implemented properly, it could ultimately ease regulatory burden for credit unions, as it calls for the establishment of reliable, verifiable databases maintained by governments to obtain beneficial ownership information. This could ease compliance burdens for credit unions at account openings and for ongoing monitoring obligations. While the international standard is moving in the right direction, it still requires implementation by national-level regulators to be successful.

FATF, however, has not been blind to the regulatory burdens that its standards often impose. It has gone to great efforts to ensure proportionality is built into all its standards. Their *High-Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards* continues to influence national-level regulators to properly tailor AML/CFT requirements. It specifically notes that the failure to proportionally tailor regulations is directly leading to financial exclusion.

FATF is also aware of the benefits respective to the ability to offer payments through the use of virtual assets, but it is also closely monitoring other developments in the cryptosphere. It notes that while some countries are starting to regulate the virtual asset sector, others have prohibited their use and the vast majority have not taken any action. These gaps create significant loopholes for criminals and terrorists to abuse the system. FATF has issued global standards to prevent the misuse of virtual assets, however, the changing technological landscape and significant gaps warrant continued work. FATF asserts that its standards are designed to ensure that virtual assets are treated fairly, applying the same safeguards as it does to the financial sector.

The Bottom Line:

AML/CFT regulations are often the greatest contributor to disproportionate regulatory burden for credit unions. Including proportionality in international standards and working with national-level regulators on implementing properly tailored regulations will be key to allowing credit unions to increase financial inclusion and supporting their ability to serve marginalized or underserved populations.

Key Documents:

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

V. CYBERSECURITY/ DIGITIZATION

Cyber incidents and cybersecurity continue to be high on the list of priorities for regulators worldwide as a risk to financial institutions. Both the frequency of and sophistication of cyber-attacks are ever increasing, and the pressure of increasing and improving cybersecurity is growing. At the same time, the cyber threat landscape is continually changing and expanding amid rapid digital transformation. Geopolitical tensions, combined with the concern over the use of third-party service providers, are at the forefront of regulatory concerns. The growing interconnectedness of the financial system increases the likelihood of a cyber incident at a financial institution or an incident at one of its third-party service providers having spill-over effects across borders and sectors. To that end, the G20 in its recent Leaders' Declaration, asked the Financial Stability Board (FSB) to deliver a report on achieving greater convergence in cyber incident reporting.

2022 also saw the adoption of the Digital Operational Resilience Act (DORA) in the EU, with a five-pillar approach to cybersecurity by addressing areas of:

- ICT Risk Management;
- ICT related incident reporting;
- digital operational resilience testing;
- ICT third-party risk; and
- information sharing.

DORA focused on strengthening the financial sector's resilience to ICT (Information and communication technology)-related incidents and introduced very specific and prescriptive requirements across the entire EU. Critical ICT third parties, which provide ICT-related services to financial institutions, such as cloud platforms, data analytics and audit services, were brought into the scope of this new framework. Notably, the act demonstrated a high level of involvement by EU regulators with a hands-on approach to reporting, communication and assessments that need to take place on a frequent basis, with a single supervisory approach. Other jurisdictions are expected to model this approach to revisions.

Due to advocacy efforts by the World Council International Advocacy team and the European Network of Credit Unions (ENCU), the EU acknowledged the need for proportionality in DORA, allowing national-level regulators to tailor many aspects of the regulation for credit unions. Without such tailoring, many credit unions would be unable to continue their operations. It is also noteworthy the EU adopted DORA alongside the Markets in Crypto-assets regulation (MiCA), which is responsible for regulating virtual assets. The connection between virtual assets and cybersecurity is one that cannot be overlooked.

Anticipate that cybersecurity will continue to be a top concern for many regulators, as the sophistication of attacks continues to rise, and costs associated with them continue to increase. Expect regulators in 2023 to also focus on the fact that human error and behavior are often the weak points in many cybersecurity preventative measures.

The Bottom Line:

Cybersecurity continues to be a priority for many regulators, representing a systemic risk for all financial institutions. International standard setters continue to work on standards and other information-sharing tactics to strengthen the financial sector. Foreseeably, there will be additional regulations that will alter how credit unions are addressing cybersecurity concerns.

Key Documents:

Financial Stability Board consultative document on Achieving Greater Convergence in Cyber Incident Reporting

VI. CONCLUSION

The regulatory landscape continues to evolve at a rapid pace but is struggling to keep up with and adapt to the evolving technology and increasing sophistication of the marketplace. The key for credit unions is to ensure that the member-owned cooperative model is not only acknowledged by the regulators but supported as well. Proportionality is often the key to achieving this regulatory paradigm. The unique community-based, member-owned structure of credit unions brings with it inherent consumer protections and a focus on local communities. When the NorthStar of the financial institution is its members and not shareholders, the ability of credit unions to catalyze rebuilding, support its communities where others will not, and provide responsible and affordable financial services to all, becomes paramount. Policymakers must embrace this.

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