World Council

October 14, 2018

Sent via Email
Member Agencies of the Global Financial Innovation Network (GFIN) Chair
c/o the Financial Conduct Authority (FCA) of the United Kingdom
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Re: Consultation document: *Global Financial Innovation Network (GFIN)*

Dear GFIN Member Agencies:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Member Agencies of the proposed Global Financial Innovation Network's[1] (GFIN) consultation document: *Global Financial Innovation Network (GFIN)*.[2] Credit unions are cooperative depository institutions and World Council is the leading trade association and development organization for the international credit union movement. Worldwide, there are over 68,000 credit unions in 109 countries with USD 1.8 trillion in total assets serving 235 million physical person members.[3]

Q1: Do you agree with the proposed Mission Statement for the GFIN?

World Council supports most aspects of the GFIN's proposed mission statement but urges the Member Agencies of the GFIN also to include the principles of a level regulatory playing field and the principle of proportionality[4] in the GFIN's mission statement, by adding the following underlined text:

> "The GFIN is a collaborative policy and knowledge sharing initiative aimed at advancing areas including financial integrity, consumer wellbeing and protection, financial inclusion, competition and financial stability through innovation in financial services, <u>while ensuring a level playing field and the principle of proportionality,</u> by sharing experiences, working jointly on emerging policy issues and facilitating responsible cross-border experimentation of new ideas."

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[1] The Member Agencies of the GFIN include: (1) Abu Dhabi Global Market (ADGM); (2) Autorité des marchés financiers (AMF, Québec, Canada); (3) Australian Securities & Investments Commission (ASIC); (4) Central Bank of Bahrain (CBB); (5) Bureau of Consumer Financial Protection (BCFP, USA); (6) Dubai Financial Services Authority (DFSA); (7) Financial Conduct Authority (FCA, UK); (8) Guernsey Financial Services Commission (GFSC); (9) Hong Kong Monetary Authority (HKMA); (10) Monetary Authority of Singapore (MAS); (11) Ontario Securities Commission (OSC, Ontario, Canada); and (12) Consultative Group to Assist the Poor (CGAP).

[2] GFIN Member Agencies, Consultation document: *Global Financial Innovation Network (GFIN)* (Aug. 2018), *available at* http://www.fsb.org/2018/08/thematic-peer-review-on-implementation-of-the-legal-entity-identifier-summary-terms-of-reference/.

[3] World Council, *Statistical Report* (2017), *available at* https://www.woccu.org/impact/global_reach/statreport.

[4] *See, e.g.*, Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision* ¶¶ 4, 17 (Sep. 2012), *available at* https://www.bis.org/publ/bcbs230.pdf; Basel Committee on Banking Supervision, *Basel III: A global regulatory framework for more resilient banks and banking systems* ¶ 34 (June 2011), *available at* https://www.bis.org/publ/bcbs189.pdf.

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The Basel Committee on Banking Supervision, the Financial Stability Institute and other international organizations as well as national-level and provincial-level regulatory agencies have endorsed the principles of a level regulatory playing field and the principle of proportionality as essential principles for ensuring fair and reasonable international regulatory principles in the area of financial institution regulation.[5]

Over the last several years technological innovation in the financial sector has led technology companies and other non-traditional financial companies to offer many financial products and services that have traditionally been offered by credit unions and other depository institutions that are subject to stringent safety and soundness prudential regulations in addition to stringent anti-money laundering/countering the financing of terrorism (AML/CFT) rules, consumer protection rules and other conduct rules.

This is not always the case for other companies offering financial products, particularly "Financial Technology" (Fintech) companies, which seek to offer much the same products and services as traditional depository institutions engaged in the "business of banking," such as credit unions and mutual banks,[6] but without Fintechs and other non-traditional financial firms being subject to the high compliance burdens associated with being an authorized depository institution.

All participants in the financial sector should be subject to the same comprehensive and effective AML/CFT rulebook in order to prevent Fintechs and other non-traditional financial firms from being conduits for money laundering and/or the financing of terrorism or of the proliferation of weapons of mass destruction. Similarly, all financial firms should be subject to a comprehensive set of financial conduct rules to ensure that consumers are protected from unethical conduct.

Fintechs and other non-traditional firms accepting deposits or similar repayable funds, however, should also be subject to the same or similar rules to those that apply to other depository institutions in the local jurisdiction.

Credit unions and other cooperative depository institutions such as mutual banks and mutual building societies are typically subject to significantly higher regulatory burdens than are firms in the Fintech sector and other non-traditional firms. Credit unions, mutual banks and mutual building societies in some jurisdictions are subject to full Basel III compliance as well as compliance with all other Basel standards.[7]

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[5] *See, e.g.*, Financial Stability Institute, FSI Insights on policy implementation No 1: *Proportionality in banking regulation: a cross-country comparison* (Aug. 2017), *available at* https://www.bis.org/fsi/publ/insights1.pdf.

[6] *See, e.g.*, *NationsBank, N.A. v. VALIC*, 513 U.S. 251, 255 (1995) ("The Comptroller . . . concluded that national banks have authority to broker annuities within 'the business of banking' under 12 U.S.C. § 24 Seventh."); *see* 12 U.S.C. § 24(7) ("To exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes . . ."); Letter of Michael J. McKenna, General Counsel, US National Credit Union Administration, "Authority to Issue and Sell Securities" (June 21, 2017), *available at* https://www.ncua.gov/regulation-supervision/Pages/rules/legal-opinions/2017/asset-securitization-authority.pdf ("Applying the reasoning of [the US Supreme Court's decision in] *VALIC* to § 107(17) of the [US Federal Credit Union Act], 'the business for which [a credit union] is incorporated' is not limited to the express powers in that section.").

[7] *See, e.g.*, Australian Prudential Regulation Authority (APRA); "Authorized deposit-taking institutions standards and guidance;" https://www.apra.gov.au/adi-standards-and-guidance (last visited Oct. 14, 2018); Office of the Superintendent of Financial Institutions (OSFI) of Canada, "Table of Guidelines;" http://www.osfi-bsif.gc.ca/Eng/fi-

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Even when credit unions are subject to non-Basel III based standards, such as in several European countries and other jurisdictions such as Singapore,[8] these credit unions are often subject to far more restrictive rulebooks than are Basel III-compliant commercial banks.

This is especially true in terms of credit unions' capital requirements—such as minimum leverage ratio requirements as high as 10 percent relative to the credit union's total assets[9]—and extremely restrictive portfolio-shaping rules that limit credit unions' permissible business activities primarily to making loans to members, investing in deposits held by banks or other credit unions, and investing in government-guaranteed debt instruments.[10]

Further, as institutions that make loans and accept deposits or similar repayable funds, credit unions' authority to conduct business activities traditionally associated with the "business of banking" without full Basel-III compliance has typically required legislation, such as in the European Union.[11]

World Council believes that Fintech companies conducting activities within the "business of banking" should be subject to no less stringent regulations those that apply to credit unions, mutual banks and other community-based cooperative depository institutions in the same jurisdiction. Traditionally, firms accepting repayable funds from the public without a depository institution charter or license were regarded as "warehouse banks" that were and remain unlawful in many jurisdictions. In addition, we believe that legislative authority is typically necessary for Fintechs and other non-traditional firms to perform business activities that are traditionally associated with the "business of banking."

World Council supports most aspects of the GFIN's proposed mission statement but urges the Member Agencies of the GFIN also to include the principles of a level regulatory playing field and the principle of proportionality in the GFIN's mission statement.

Q2: Do you agree with the three main proposed functions for the GFIN?

World Council believes that the three main proposed functions of the GFIN—(a) acting as a network of regulators; (b) undertaking joint policy work and regulatory trials; and (c) conducting cross-border trials—are logical for an international standard setting body such as the proposed GFIN.

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if/rg-ro/gdn-ort/gl-ld/Pages/default.aspx (last visited Oct 14, 2018).

[8] *See, e.g.*, *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance*, 2013 O.J. (L176) 338, 350, Art. 2(5) [hereinafter "CRD IV"] (exempting credit unions, savings banks, postal banks and other types of banking institutions in various EU Member States from most, but not all, requirements of the EU's fourth Capital Requirements Directive (CRD IV) and Capital Requirements Regulation (CRR)).

[9] *See, e.g.*, Central Bank of Ireland, "Reserves," *Credit Union Handbook*, Ch. 17 (2016) (". . . [A] credit union shall establish and maintain a minimum regulatory reserve requirement of at least 10 per cent of the assets of the credit union."), *available at* https://www.centralbank.ie/regulation/industry-market-sectors/credit-unions/credit-union-handbook; 12 U.S.C. § 1790d(c) ("An insured credit union is 'well capitalized' if— (i) it has a net worth ratio of not less than 7 percent; and (ii) it meets any applicable risk-based net worth requirement . . ."), *available at* https://www.law.cornell.edu/uscode/text/12/1790d.

[10] *See, e.g.*, 12 U.S.C. § 1757 (establishing the permissible business activities of federally chartered credit unions in the USA by statute), *available at* https://www.law.cornell.edu/uscode/text/12/1757; 12 C.F.R. Part 703 ("Investment and Deposit Activities."), *available at* https://www.gpo.gov/fdsys/pkg/CFR-2018-title12-vol7/pdf/CFR-2018-title12-vol7-part703.pdf.

[11] *See, e.g.*, CRD IV, Art. 2(5).

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While World Council supports national-level and provincial-level "sandboxes" and similar pilot programs to promote regulatory innovation,[12] especially in the area of prudential safety and soundness regulation, we believe that such pilot programs are best conducted at the national or provincial level. We question the necessity of conducting cross-border trials and we do not support that aspect of this proposal.

Q3: What aspects/areas of regulation pose the biggest challenge when it comes to innovating?

For authorized depository institutions such as credit unions and mutual banks the biggest challenges to innovating in terms of regulation are prudential safety and soundness regulations. Even when a particular business activity is authorized for a credit union, mutual bank or other community-based financial cooperative to perform, the depository institution's prudential supervisory agency often objects on a case-by-case basis to particular institutions utilizing those legal authorities on "safety and soundness" grounds, such as that the new activity in question poses unacceptably high credit, operational, market or reputational risks, among other things.

Fintech companies and other non-traditional financial firms are typically not subject to prudential safety and soundness regulation on a comprehensive, consolidated basis in the same manner as are credit unions, mutual banks and similar depository institutions in the jurisdiction in question.

Safety and soundness rules, however, are essential for protecting the savings of depositors from risk of loss. This is especially true with respect to companies that are not part of a deposit insurance system or a similar savings guarantee scheme.

World Council urges the GFIN to make the protection of depositors from risk of loss a fundamental aim of the GFIN, especially in jurisdictions where Fintechs and other non-traditional financial firms accept deposits or similar repayable funds from the public.

Q4: Do you see any reasons why this initiative may be counterproductive to the outcomes it is seeking to achieve?

World Council urges the GFIN to exercise caution in granting exemptions from existing regulations for so-called "new" activities that are really traditional "business of banking" activities delivered through a new channel and which that constitute a form of shadow banking.

In addition, Silicon Valley-based firms, in particular, are not particularly well-known for having a culture of regulatory compliance. For example, Euwyn Poon, co-founder of the scooter rental company Spin, was recently quoted in the press as describing his company placing electric rental scooters in public spaces in several cities in the United States of America without first seeking licenses or permits from local regulatory authorities as "innovating on the regulatory side."[13]

Fintech firms seeking exemptions from existing financial regulations—which often place unreasonably high compliance costs on credit unions, mutual banks and other community-based cooperative depository institutions—is crucial to the Fintech business model.

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[12] *See, e.g.*, FCA of the UK, "Regulatory Sandbox;" https://www.fca.org.uk/firms/regulatory-sandbox (last visited Oct. 14, 2018); 12 C.F.R. § 703.19 ("Investment pilot program."), *available at* https://www.gpo.gov/fdsys/pkg/CFR-2018-title12-vol7/pdf/CFR-2018-title12-vol7-part703.pdf.

[13] *E.g.*, Peter Holley, "The life of an electric scooter: Nasty, brutish and often short," *Washington Post* (July 27, 2018), *available at* https://www.washingtonpost.com/technology/2018/07/27/life-an-electric-scooter-nasty-brutish-sometimes-short/.

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In essence, these firms' business models are often an effort at regulatory arbitrage, i.e. to avoid the costs of regulation that apply to their competitors in order to gain an advantage in the market through lower overhead costs. World Council does not support a scenario where the GFIN is utilized by Fintechs and other non-traditional firms to engage in this type of regulatory arbitrage on a cross-border or global level.

World Council also believes that many Fintech firms that have attempted to seek regulatory exemptions from the Financial Conduct Authority (FCA) of the United Kingdom's "regulatory sandbox" have typically tried to do so too early in the process of developing their proposed products and services for the FCA to be able to consider whether granting an exemption is warranted or not. We believe that Fintechs and other non-traditional financial firms' history of "jumping the gun" in terms of applying for regulatory exemptions is indicative of the corporate culture of these firms, which is too often not consistent with a culture of regulatory compliance.

World Council urges the GFIN Member Agencies to exercise caution in granting exemptions from existing financial regulations for so-called "new" activities that are really traditional "business of banking" activities delivered through a new channel, especially when such firms are essentially engaging in shadow banking activities without being subject to comprehensive prudential safety and soundness supervision on a consolidated basis.

World also Council also urges the GFIN Member Agencies to ensure that Fintechs and other non-traditional financial firms are subject to comprehensive AML/CFT, consumer protection and other conduct regulations that are equivalent to the rules that apply to credit unions and community-based banks in the same jurisdiction. This includes "sandbox" firms being subject to the same fitness and probity standards that apply to the senior managers and board members of credit unions and banks in order better to ensure that these firms develop and maintain a culture of regulatory compliance.

Q5: Do you believe the issue of developing a best practice for regulators when assessing financial innovation should be a priority for the network? If not, what other priorities should the network first address?

World Council urges the GFIN Member Agencies to make their highest priority developing a set of best practices for extending regulation to Fintech firms that are presently under-regulated and/or engaged in shadow banking. We believe that the GFIN Member Agencies should build upon the work of the Basel Committee on Banking Supervision's recent standard on the regulation of Fintech firms finalized in February 2018 entitled *Sound Practices: Implications of fintech developments for banks and bank supervisors*.[14]

The GFIN Member Agencies developing a set of best practices to help enhance the AML/CFT regulation, consumer protection and other conduct regulation, and prudential safety and soundness regulation of Fintechs and other non-traditional financial firms will help reduce these firms attempting to use the "global sandbox" to gain a market advantage by achieving regulatory arbitrage opportunities that allow them to avoid the compliance burdens borne by credit unions and banks.

[14] Basel Committee on Banking Supervision, *Sound Practices: Implications of fintech developments for banks and bank supervisors* (Feb. 2018), *available at* https://www.bis.org/bcbs/publ/d431.htm.

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Q6: Do you agree with the approach to involve global standard setting bodies as part of the GFIN? How else would you like to see these organisations involved?

World Council strongly urges the GFIN Member Agencies to achieve a high-level of coordination and cooperation with other global standard setting bodies, especially the Basel Committee on Banking Supervision, the Financial Action Task Force and the Financial Stability Board.

World Council also urges the GFIN Member Agencies to make the Basel Committee, the Financial Action Task Force, the Financial Stability Board and other financial international standard setting bodies full members of the GFIN.

Involvement of the Basel Committee, the Financial Action Task Force, the Financial Stability Board, and other international standard setters in the GFIN's work will help better ensure a level regulatory playing field that is consistent with the principle of proportionality whereby Fintechs and other non-traditional financial firms will be subject to rulebooks that are substantially equivalent to those that apply to their competitors in the same jurisdiction.

Q7: What kind of outcomes from the policy work and regulatory trials would your organisation benefit from?

The proposed GFIN "global sandbox" is most likely to benefit Fintechs and other competitors of credit unions and mutual banks, to the extent that it grants these non-traditional financial firms exemptions from regulations that apply to their competitors.

World Council urges the GFIN to prioritize creating more consistent and bank-like regulations internationally for Fintechs and other firms seeking to engage in much the same business activities that community-based authorized depository institutions such as credit unions and mutual banks engage in.

Q8: Would the cross-border trials be of interest to your organisation? If so, could you provide any potential example use cases?

Credit unions, mutual banks and other community-based cooperative depository institutions are unlikely to be able to benefit from the GFIN's cross-border "global sandbox" trials.

Credit unions and mutual banks are community-based depository institutions that rarely operate on a cross-border basis. This is often due to "common bond" restrictions that limit who may become a member of a credit union.[15]

Other times, credit unions and mutual banks are community-based institutions simply because the institution is a relatively small depository institution compared to the Global-Systemically Important Banks and other internationally active banking institutions, and the credit unions or mutual bank must therefore follow a community banking business model as an operational reality.

[15] *See, e.g.*, 12 U.S.C. § 1759(b) ("Membership field"), *available at* https://www.law.cornell.edu/uscode/text/12/1759.

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Q9: Do you agree with the proposed approach to managing the application process for cross-border trials?

World Council does not support the GFIN Member Agencies' proposed approach to managing the cross-border trial application process because the proposed substantive standards for granting an exemption are vague and potentially arbitrary.

World Council also does not support the GFIN's proposed application procedures because it does not include a public consultative process. We urge the GFIN Member Agencies to require a public notice and comment period of at least sixty (60) days prior to granting a potentially global exemption from existing financial regulations to Fintechs and other non-traditional financial firms.

We do not believe that granting some types of financial firms exemptions from existing laws on a potentially global basis using a seemingly ad hoc process without specified substantive standards or a public consultative process would be consistent with due process and the rule of law.[16]

World Council appreciates the opportunity to comment on the GFIN Member Agencies' consultation document: *Global Financial Innovation Network (GFIN)*. If you have questions about our comments, please feel free to contact me at medwards@woccu.org or +1.202.843.0702.

Sincerely,

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World Council of Credit Unions

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[16] *See, e.g.*, 5 U.S.C. § 553 ("Rule making."), *available at* https://www.law.cornell.edu/uscode/text/5/553; *Chevron U.S.A., Inc. v. NRDC*, 467 U.S. 837, 842-44 (1984), *available at* https://www.law.cornell.edu/supremecourt/text/467/837 (holding that if Congress's intent in a statutory provision is ambiguous, then the agency's delegated rulemaking interpretations of that legislation must be reasonable); *Skidmore v. Swift and Co.*, 323 U.S. 134, 140 (1944), *available at* https://www.law.cornell.edu/supremecourt/text/323/134 ("We consider that the rulings, interpretations and opinions of the Administrator under this Act, while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.")

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