World Council

October 31, 2017

***Filed electronically***
William Coen
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Consultative Document – *Sound Practices: Implications of fintech developments for banks and bank supervisors* (Aug. 2017)

Dear Mr. Coen:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Basel Committee on Banking Supervision's (Committee) Consultative Document *Sound Practices: Implications of fintech developments for banks and bank supervisors*.[1] 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 60,000 credit unions in 109 countries with USD 1.8 trillion in total assets serving 223 million physical person members.[2]

World Council supports the Committee's proposal that Financial Technology ("fintech") companies be subject to comprehensive prudential, consumer protection, data security and anti-money laundering/countering the financing of terrorism (AML/CFT) regulation. Fintech companies are technology companies that typically do not have a depository institution charter but offer financial services within the "business of banking."[3] We urge the Committee to promote a regulatory level playing field by ensuring that fintech companies are subject to the same regulatory requirements that apply to authorized deposit-taking institutions such as banks, credit unions, and building societies.



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[1] Basel Committee on Banking Supervision, *Sound Practices: Implications of fintech developments for banks and bank supervisors* (Aug. 2017), *available at* https://www.bis.org/bcbs/publ/d415.htm.
[2] World Council of Credit Unions, *2015 Statistical Report* (2016), *available at* https://www.woccu.org/documents/2015_Statistical_Report_WOCCU.
[3] *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.").

## World Council's Comments

1) ***Recommendation 1**: Banks and bank supervisors should consider how they balance ensuring the safety and soundness of the banking system with minimising the risk of inadvertently inhibiting beneficial innovation in the financial sector. Such a balanced approach would promote the safety and soundness of banks, financial stability, consumer protection and compliance with applicable laws and regulations, including anti-money laundering and countering financing of terrorism (AML/CFT) regulations, without unnecessarily hampering beneficial innovations in financial services, including those aimed at financial inclusion.*

World Council supports proposed Recommendation 1's requirement that fintech companies be subject to safety and soundness, consumer protection and AML/CFT rules. Fintech companies should be subject to the same or equivalent regulations as authorized deposit-taking institutions such as banks, credit unions and building societies in order to protect the public, ensure financial stability, and promote a regulatory level playing field. While a smaller fintech company could be subject to a lighter rulebook than a large fintech in order to achieve the principle of proportional regulation, community-based depository institutions such as credit unions should also benefit from the regulatory burden relief of such proportional rules.

We urge the Committee, however, to emphasize in the final version of this guidance that fintech companies should be subject to data protection regulations to at least the same extent as authorized deposit-taking institutions. While we acknowledge that data protection is discussed elsewhere in this paper, data protection should be listed expressly in Recommendation 1 because data protection is a paramount issue for fintech companies. Fintechs have vast troves of consumer and business account information whether they operate with a direct customer relationship or are acting as a vendor to a depository institution. In the vendor scenario, the credit union or other depository institution using the fintech as a vendor is likely also legally responsible for protecting this client information. Further, the recent Equifax data breach that exposed the credit histories and personal details of up to 143 million people illustrates not only the potential disastrous consequences of a data breach at a fintech company, but also that fintech companies are high profile targets for hackers.

We believe that the Committee can best emphasize the importance of data protection as a fintech regulatory requirement by inserting "data protection" in Recommendation 1 as follows:

> ***Recommendation 1**: Banks and bank supervisors should consider how they balance ensuring the safety and soundness of the banking system with minimising the risk of inadvertently inhibiting beneficial innovation in the financial sector. Such a balanced approach would promote the safety and soundness of banks, financial stability, consumer protection<u>, data protection</u> and compliance with applicable laws and regulations, including*

*anti-money laundering and countering financing of terrorism (AML/CFT) regulations, without unnecessarily hampering beneficial innovations in financial services, including those aimed at financial inclusion.*

World Council supports proposed Recommendation 1's requirement that fintech companies be subject to safety and soundness, consumer protection and AML/CFT rules, but we urge the Committee also to include "data protection" requirements for fintechs in the final version of Recommendation 1 in order to promote a regulatory level playing field and better ensure the protection of client information.

2) ***Recommendation 2**: Banks should ensure that they have effective governance structures and risk management processes in order to identify, manage and monitor risks associated with the use of enabling technologies and the emergence of new business models and entrants into the banking system brought about by fintech developments. These structures and processes should include:*
   - *robust strategic and business planning processes that allow banks to adapt revenue and profitability plans in view of the potential impact of new technologies and market entrants; sound new product approval and change management processes to appropriately address changes not only in technology, but also in business processes;*
   - *implementation of the Basel Committee's Principles for sound management of operational risk (PSMOR) with due consideration to fintech developments; and*
   - *monitoring and reviewing of compliance with applicable regulatory requirements, including those related to consumer protection, data protection and AML/CFT when introducing new products, services or channels.*

World Council supports the Committee's proposal in Recommendation 2 that depository institutions using fintech companies as vendors should have robust business planning, due diligence, monitoring, governance, compliance and other processes to manage the fintech vendor relationships.

World Council supports the Committee's reference in Recommendation 2 to its 2011 guidance on *Principles for sound management of operational risk (PSMOR),*[4] but we urge the Committee to clarify that these operational risk rules should be applied in a proportionate manner by inserting the following in the second bullet-point:

- *implementation of the Basel Committee's Principles for sound management of operational risk (PSMOR) <u>proportionate to complexity and</u> with due consideration to fintech developments; and*

The Committee's 2011 operational risk guidance paper and this paper's proposed commentary on Recommendation 2 do not expressly discuss proportional application

[4] Basel Committee on Banking Supervision, *Principles for sound management of operational risk (PSMOR)* (June 2011), *available at* https://www.bis.org/publ/bcbs195.pdf.

of these operational risk rules based on institutional complexity or the complexity of the control environment in question. Large banks are much more operationally complex than community-based financial institutions, and these large, complex banks should be subject to stringent operational risk safety and soundness measures that are commensurate with their increased complexity. Applying rules designed for large, complex banks to community-based financial institutions such as credit unions, however, typically would impose outsized compliance burdens on smaller financial institutions that would neither be necessary to achieve safe and sound operations nor be consistent with the principle of proportionality.

Credit unions and other community-based financial cooperatives are typically subject to stringent enterprise risk management requirements that are the same as those applicable to large banks but scaled to the complexity of the institution. Community-based financial cooperatives also frequently form wholesale “central” credit unions and/or service bureaus to achieve increased economies of scale that help their member institutions reduce and share the costs of fintech systems through increased scale and the avoidance of redundant systems. Under the principle of proportionality, community-based financial institutions should be able to continue to use shared service models for payments and other financial technology-related systems even if large banks generally establish such systems in-house.

In addition, credit unions and other community-based depository institutions already provide payments services and other financial services that fintechs seek to provide as well. We urge the Committee not to suggest that regulations designed for fintech companies should apply to authorized deposit-taking institutions that already provide similar financial services, such as payments.[5] Applying rules designed for non-depository fintechs to depository institutions would create unnecessary compliance burdens on credit unions and other community-based financial cooperatives that would not be consistent with the principle of proportionality.

We urge the Committee to include the principle of proportional regulation expressly in the final version of Recommendation 2.



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[5] See, for example, the Canadian Credit Union Association’s recent comment letter to the Department of Finance Canada regarding Canada’s proposed regulation of “payments service providers.” Letter of Brenda O’Connor, Vice President, Governance & Strategy, General Counsel & Corporate Secretary, Canadian Credit Union Association, to Department of Finance Canada, “Re: Consultation on a New Oversight Framework for Retail Payments” (Oct. 6, 2017), *available at* https://ccua.com/government_relations/submissions_appearances (“Despite the exemptions outlined, the very broad characterization of core [Payment Service Provider] PSP functions will, in practice, capture most if not all, ‘traditional’ players in the payments space, many of whom like credit unions are part of a distinct sub-set of Canadian financial service providers that are deposit-taking institutions. These institutions are already heavily regulated from both a prudential and market conduct perspective and are required to address the five broad categories of risk identified in the new framework in their day-to-day operations by the other regulatory and governance frameworks in which they participate. They are also subject to various market conduct rules and often further protect participant interests through commercial contracts.”).

3) ***Recommendation 3**: Banks should ensure they have effective IT and other risk management processes that address the risks of the new technologies and implement the effective control environments needed to properly support key innovations.*

World Council supports the Committee's proposed Recommendation 3. We agree that institutions should have IT and related risk-management processes that are "effective" relative to the complexity of the technological arrangement in question (i.e. an "effective control environment").

As with Recommendation 2, which also addresses aspects of fintech risk management, we believe that Recommendation 3 should be implemented consistently with the principle of proportionality. Proportional application of Recommendation 3 is implied by the Committee proposed terms "effective IT" and "effective control environment." We urge the Committee to finalize Recommendation 3 as proposed.

4) ***Recommendation 4**: Banks should ensure they have appropriate processes for due diligence, risk management and ongoing monitoring of any operation outsourced to a third party, including fintech firms. Contracts should outline the responsibilities of each party, agreed service levels and audit rights. Banks should maintain controls for outsourced services to the same standard as the operations conducted within the bank itself.*

World Council supports Recommendation 4 as proposed. We agree that depository institutions should have "appropriate processes" for due diligence, monitoring, and enterprise risk management for fintech vendors. As with Recommendations 2 and 3, we believe that these enterprise risk management activities should be proportionate to the institution's and control environment's complexity.

Recommendation 4's proposed term "appropriate processes" implies that these risk-management processes should be scaled to the institution's and control environment's complexity in a manner consistent with the principle of proportionality. World Council urges the Committee to finalize Recommendation 4 as proposed.

5) ***Recommendation 5:** Bank supervisors should cooperate with other public authorities responsible for oversight of regulatory functions related to fintech, such as conduct authorities, data protection authorities, competition authorities and financial intelligence units, with the objective of, where appropriate, developing standards and regulatory oversight of the provision of banking services, whether or not the service is provided by a bank or fintech firms.*

World Council supports Recommendation 5 as proposed. All companies operating in the "business of banking"—including fintechs—should be subject to comprehensive

supervision on a consolidated basis, as is the case with authorized deposit-taking institutions such as banks, credit unions and building societies.

In terms of what agency should be the lead regulator of fintech firms, we believe that the prudential supervisors of depository institutions, such as central banks, are the best positioned agencies to regulate fintech firms that accept repayable funds from the public, including fintechs offering electronic payments services. We agree that different regulatory agencies should work together to ensure that all fintech companies offering services within the "business of banking" are regulated similarly in order to protect the public in terms of safeguarding deposits from unsafe and unsound practices, to promote consumer protection, to promote data security, to combat money laundering and the financing of terrorism, and to ensure a regulatory level playing field.

In the European Union (EU), for example, "all undertakings the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account" must be regulated as "credit institutions."[6] Even in Member States where credit unions or some other types of credit institutions, such as post office giro institutions or development banks, are exempt from most of the EU's capital requirements directive (CRD IV) pursuant to Article 2(5) of that directive, these institutions must be comprehensively regulated by Member State competent authorities as deposit-taking "financial institutions" pursuant to Articles 34 and 2(6) of the European Union's CRD IV.[7]

A fintech accepting repayable funds from the public—including fintechs offering payments products that operate similarly to depository checking and current accounts—should be regulated as a depository institution because it is acting as a deposit-taking institution whether or not it is authorized to do so.

Members of the public trusting fintech companies with their repayable funds may not be aware that many fintechs are not subject to prudential safety and soundness regulations and/or that their money is not protected by deposit insurance or a savings guarantee scheme. Depository institution regulatory agencies have extensive experience regulating depository institution safety and soundness and are therefore the supervisory agencies best positioned to regulate the safety and soundness of fintech companies that accept repayable funds from the public.

We urge the Committee to finalize Recommendation 5 as proposed.



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[6] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, 2013 O.J. (L176) 1, 18, Art. 4(1), *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013R0575.

[7] *See* 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, 2013 O.J. (L176) 338, 350-51, Arts. 2(5), 2(6), 34, *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013L0036.

6) ***Recommendation 6****: Given the current and potential global growth of fintech companies, international cooperation between supervisors is essential. Supervisors should coordinate supervisory activities for cross-border fintech operations, where appropriate.*

World Council supports Recommendation 6 as proposed. We believe that fintech companies should be subject to comprehensive supervision on a consolidated basis, as is the case for authorized deposit-taking institutions including credit unions. Consolidated comprehensive supervision can only be achieved in a cross-border context if supervisors in different jurisdictions cooperate with one-another and regulate the fintech company as a supervisory college.

We urge the Committee to finalize Recommendation 6 as proposed.

7) ***Recommendation 7****: Bank supervisors should assess their current staffing and training models to ensure that the knowledge, skills and tools of their staff remain relevant and effective in supervising new technologies and innovative business models. Supervisors should also consider whether additional specialised skills are needed to complement existing expertise.*

World Council agrees with the Committee's proposed Recommendation 7, however, we note that the prudential regulators of credit unions and other community-based financial cooperatives often have limited budgetary and staff resources.

The compliance burdens on supervisory agencies from global standards can be as palpable as the compliance burdens that those global standards impose on community-based financial cooperatives such as credit unions and other mutuals.

Recommendation 7 does use some proportional terminology such as "effective," but the Committee's discussions with national-level supervisors and future mutual evaluations of national-level supervisors' fintech regulatory programs should also take proportionality into account.

The principle of proportional regulation is essential both in terms of limiting compliance burdens on regulated institutions and in terms of limiting burdens on the regulatory agency itself. Proportional regulation helps ensure that the supervisory agencies' often limited resources are available to be utilized in a risk-based manner proportionate to their regulated institutions' size, risk and complexity. Misallocated supervisory resources can be a threat to financial stability.

We urge the Committee to finalize Recommendation 7 as proposed, but also to observe the principle of proportionality in practice, such as during mutual evaluations, in order to ensure that national-level supervisors' limited resources can be used in a risk-based and proportionate manner.

8) ***Recommendation 8****: Supervisors should consider investigating and exploring the potential of new technologies to improve their methods and processes. Information on policies and practices should be shared among supervisors.*

World Council supports Recommendation 8 as proposed because it does not mandate the adoption of new regulatory technologies (i.e. "Regtech"). We believe that Regtech can be useful for supervisors in some situations but that the use of Regtech should not be mandated because Regtech can be expensive for supervisory agencies with limited budgets as well as potentially expensive for community-based financial institutions if the use of Regtech is required.

Credit unions and other depository institutions typically finance the operations of their supervisory agencies directly through examination fees and/or indirectly by foregoing potential dividends from or interest income generated by deposit insurance funds. Costs imposed by global standards on national-level regulators are often paid for by their regulated institutions.

We urge the Committee to finalize Recommendation 8 as proposed.

9) ***Recommendation 9:*** *Supervisors should review their current regulatory, supervisory and licensing frameworks in light of new and evolving risks arising from innovative products and business models. Within applicable statutory authorities and jurisdictions, supervisors should consider whether these frameworks are sufficiently proportionate and adaptive to appropriately balance ensuring safety and soundness and consumer protection expectations with mitigating the risk of inadvertently raising barriers to entry for new firms or new business models.*

World Council strongly supports Recommendation 9 and urges the Committee to finalize it as proposed. We believe that fintech companies operating in the "business of banking" should be subject to the same or equivalent regulations as authorized deposit-taking institutions such as banks, credit unions and building societies in order to protect the public, ensure financial stability, counter money laundering and the financing of terrorism, and promote a regulatory level playing field.

Regulatory arbitrage by fintechs—i.e. exploiting loopholes in outdated rules to circumvent the compliance burdens that apply to authorized deposit-taking institutions—raises significant consumer protection, money laundering/terrorist financing, data security, and financial stability concerns, in addition to level playing field concerns. To protect the public, fintech companies that are not depository institutions should be required to include prominent language in advertisements stating that the repayable funds they accept from the public are not protected by deposit insurance or a savings guarantee scheme.

While a smaller fintech company could be subject to a lighter rulebook than a large fintech in order to achieve the principle of proportional regulation, community-based depository institutions such as credit unions should also benefit from the regulatory burden relief of these proportional rules. "Proportionate and adaptive" regulations of the type suggested here for fintechs are urgently needed to reduce unnecessary compliance burdens on community-based financial institutions as well.

World Council strongly supports Recommendation 9 and urges the Committee to finalize it as proposed.

10) ***Recommendation 10****: Supervisors should learn from each other's approaches and practices, and consider whether it would be appropriate to implement similar approaches or practices.*

World Council supports Recommendation 10. Fintech is still an emerging supervisory discipline and some degree of national-level discretion and experimentation could help achieve proportional fintech regulations that are effective. We believe, however, that fintech companies operating in the "business of banking" should be subject to the same or equivalent regulations as authorized deposit-taking institutions such as banks, credit unions and building societies in order to protect the public, counter money laundering and the financing of terrorism, ensure financial stability, and promote a regulatory level playing field.

World Council appreciates the opportunity to comment to the Committee on the Consultative Document *Sound Practices: Implications of fintech developments for banks and bank supervisors*. If you have questions about our comments, please feel free to contact me at medwards@woccu.org or +1.202.508.6755.

Sincerely,

Michael S. Edwards
VP and General Counsel
World Council of Credit Unions