World Council

February 6, 2019

<u>Submitted electronically</u>

Monica Ellis, Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: Introduction of guidelines on interaction and cooperation between prudential and AML/CFT supervision

Dear Ms. Ellis:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on your Consultative Document on the *Introduction of guidelines on interaction and cooperation between prudential and AML/CFT supervision.*[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 85,000 credit unions in 118 countries with USD 2.1 trillion in total assets serving 274 million physical person members.[2]

World Council supports the Basel Committee on Banking Supervision's (Basel Committee) effort to improve the effectiveness of supervision of ML/FT risk management through cooperation between prudential and AML/CFT supervisors. Furthermore, we support the Basel Committee's position on the importance of proportionality by stating that, "[e]xchanges of information or other forms of cooperation should be proportionate to the risks and supervisory needs involved in each circumstance."[3] The Consultative Document further emphasizes the need for proportionality by highlighting that there are FATF Recommendations that address supervision and "describe the roles and responsibilities of supervisors, their powers and authorities to enforce AML/CFT requirements that include a range of effective, proportionate and dissuasive sanctions, and the principles of information exchange and international cooperation among different public authorities, including prudential supervisors".[4] World

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[1] Basel Committee on Banking Supervision, *Public consultation on Introduction of guidelines on interaction and cooperation between prudential and AML/CFT supervision* (November, 2019), available at: *https://www.bis.org/bcbs/publ/d483.htm and; Consultative document at: https://www.bis.org/bcbs/publ/d483.pdf.*
[2] World Council of Credit Unions, *2018 Statistical Report* (2019), *available at* http://www.woccu.org/publications/statreport.
[3] See, *Public consultation on Introduction of guidelines on interaction and cooperation between prudential and AML/CFT supervision*, paragraph 10.
[4] Id. at 5.

Council not only supports the Basel's Committee's efforts to apply proportional supervisory risk assessments of ML/FT risk, but we encourage the Basel Committee to work with AML/CFT supervisors to ensure proportionality is applied to all aspects supervisory risk assessments.

The Consultative Document suggests that prudential supervisors "consider the exposure to ML/FT risks in its assessment of soundness of the business model of the bank"[5], and that indicators such as target customers, sectors, products and services, etc. may reveal a higher ML/FT risk. Credit unions and other financial cooperative are unique in structure. Not only is a risk-based approach to assessing ML/FT risk necessary, supervisors must consider the architecture of a credit union as an organization. While the Consultative Document does address the necessity for supervisors to consider organizational structures of a financial institution when assessing management of ML/FT identifiable risks during the institution's authorization process, we ask that a credit union's cooperative structure be given priority when assessing its ML/FT risk across all categories of information shared between prudential and AML/CFT supervisors.

Credit unions are not-for-profit member-owned institutions without stockholders that demand a market rate of return on their investment, therefore, a credit union can only pass along earnings directly to their member-owners and not to outside investors. The risks associated with a member-owned financial institution are greatly reduced because of the smaller size in assets, the size of loans and issued credit, less complex structure, and diminished profit driven motivations because they are not beholden to stockholders More importantly, as member owned institutions that often contain limited fields of membership, credit unions enjoy an advantage as compared to their bank counterparts in knowing the identity of their member. Because credit unions do not have shareholders, they are at a lower risk for issues identifying beneficial owners.

Many credit unions have few staff and many rural credit unions are entirely run by volunteers, however, because customers have to go to a physical branch to open an account or receive services, the opportunities for fraud, identity theft, or AML/CFT concerns are extremely low. Credit unions, specifically, are particularly competent at "know your customer" identify verification processes because of the level of person-to-person contact and the nature of their member-owned cooperative structure and fields of membership that are often limited to a particular trade, industry, or profession.

"ML/FT risks could impact the prudential supervisor's assessment of a bank's risk management, internal controls and governance."[6] Examples of these risks provided in the Consultative Document include "…the independence and the capacity of the risk management and internal control functions dedicated to the AML/CFT activities…"[7] Small financial institutions such as credit unions have limited resources and capacity to monitor unlikely AML/CFT risks. Credit unions often have minimal financial and staff resources because of the relatively small size of their assets, as such, regulatory burden is a significant issue for credit unions. The amount of staff, training and money required to monitor AML/CFT proves to be overreaching for credit unions, especially because the risk of AML/CFT violations are so low. Credit unions usually cannot not afford to provide the additional measures requested by

[5] Id. at 13.
[6] Id. at 16.
[7] Id. at 16 (1)(c).

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regulators to mitigate risks that do not necessarily exist. Limitation on resources also include access to modern, highly developed IT systems. While "…deficiencies regarding IT systems used by the bank to manage ML/FT risks could be relevant to raising awareness of the prudential supervisor about broader IT issues"[8], supervisors should consider that credit unions do not have the sophistication that banks do when it comes to digital monitoring of ML/FT risks.

World Council agrees with the Basel Committee that prudential information regarding governance and risk management could be relevant for the AML/CFT supervisors, including factors such as ownership and structure and complexity and transparency, deficiencies in governance and management, etc. We believe, however, that a clear and congruent understanding between both prudential and AML/CFT supervisors defining what a financial cooperative is and how they function will allow a tailored and precise approach to enforcing, monitoring, and evaluating AML/CFT risks for credit unions.

Credit unions rarely, if ever, operate on a cross-border basis, however, World Council agrees with the Consultative Document's suggestion that supervisory authorities establish and maintain mechanisms with a timely and effective exchange of information and cooperation across borders; as well as the establishment of prudential and AML/CFT colleges. According to the Consultative Document, "[t]his cooperation may take place within a national authority undertaking multiple functions, between different national authorities responsible for different functions and also between different authorities in the cross-border context."[9] It is imperative that both prudential and AML/CFT supervisors stipulate exactly the method national authorities should implement when assessing credit unions for ML/FT risks. The Consultative Document also states consideration for assessing jurisdictional characteristics such as effectiveness of its legal system, level of ML/FT activities within a jurisdiction, AML/CFT management within the jurisdiction, etc. Again, World Council agrees with this approach but request the provision of clear direction to national level regulators. World Council is further concerned with observers that may participate in the colleges or other attendees participating on an ad hoc basis. While we are not opposed to this and understand the benefits from a supervisory perspective, the issue of maintaining confidentiality of non-public information needs to be of paramount importance in these colleges.

The Consultative Documents advises that when prudential and AML/CFT supervisors are not part of the same supervisory authority, they should establish confidentiality and data protection provisions. Substantial liability can accrue to a credit under various frameworks based on the handling of a member/customer's data (i.e. EU General Data Protection Regulation (EU) 2016/679, the U.S. Graham-Leach-Bliley Act/Right to Financial Privacy, Canada's Personal Information Protection and Electronics Documents Act, etc.) and the disclosure by a college (either intentionally or inadvertently) could result in difficulties for a credit union in the event of a disclosure, even if such disclosure was made by a competent authority. The increase in the number of participants and number of countries involved inherently increases the chances of a disclosure, both from intentional causes or even more so from inadvertent causes. Different countries are covered by different confidentiality provisions, thus the potential for confusion or error is great. The involvement of numerous countries and potentially various observers or other attendees also raises the risk of political malfeasance, corruption, mistake, or other sources that may not be readily apparent to the Colleges.

[8] Id. at 16(3).
[9] Id. at 2.

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WOCCU supports the confidentiality provisions of Paragraph 33 contained in section E.3, however, we recommend that the guidance be amended to include direction to national-level regulators to provide for a breach notification obligation to that any firm or institution affected by such breach should be notified as soon as reasonably practicable so that they can take appropriate remedial measures.

As the Basel Committee is aware, The European Supervisory Authorities (ESA), comprised of The European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA), and European Securities and Markets Authority (ESMA), published joint guidelines on information exchange and cooperation between the authorities regarding anti-money laundering and counter financing of terrorism (AML/CFT). Many of the adopted guidelines, including the mapping guidelines, were adopted with proportionality in mind and should not significantly increase regulatory burdens on credit unions. Further, the framework should increase the effectiveness of AML/CFT supervision. We further encourage prudential supervisors participating in AML/CFT colleges to utilize their opportunity to improve communication with AML/CFT supervisors with consideration for reducing regulatory burden on credit unions.

World Council restates it support for the objectives stated in the Consultative Document which are in line with FATF Recommendation 2, particularly the importance placed on a risk-based and proportional assessment subject to size, risk and complexity of the institution. This approach allows small financial institutions like credit unions to focus on their mission of financial inclusion through accessible and affordable financial services for the underserved. We, however, urge that prudential supervision in cooperation with AML/CFT supervisors not only apply supervision through a lens that acknowledges credit unions' unique cooperative structure, but to consider providing clear guidelines to national-level supervisors on how to assess ML/FT risk of financial cooperatives based on this unique structure, and with an eye towards reducing regulatory burden where possible. By tailoring supervisory risk assessments to smaller institutions such as credit unions reduces the administrative burdens associated with these programs who are effective in meeting the objectives of providing financing for small businesses, people of modest means, and underserved communities.

World Council appreciates the opportunity to comment on the Financial Action Task Force's, Public Consultation on FATF Draft Guidance on Digital Identity. If you have questions about our comments, please feel free to contact me at pmonford@woccu.org or +1-202-510-9347.

Sincerely,

Panya Monford, Esq.
Advocacy Counsel
World Council of Credit Unions

World Council of Credit Unions, Inc.
99 M Street SE, Ste 300, Washington, DC 20003 • +1-202-638-0205 • +1-202-638-3410
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