World Council

November 27, 2019

Delivered Via Email: FATF.Publicconsultation@fatf-gafi.org

Xiangmin Liu, President
Financial Action Task Force
FATF/GAFI
2, Rue André Pascal
75775 Paris Cedex 16 FRANCE

Re: Comments of World Council of Credit Unions on the draft Digital ID Guidance

Dear President Liu:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Public Consultation of FATF Draft Guidance on Digital Identity.[1] Credit unions are cooperative depository institutions and World Council is the leading trade association and development organization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World Council generally supports the risk-based approach contained in Financial Action Task Force's (FATF) draft guidance, which is intended to help governments, financial institutions and related entities apply a risk-based approach to digital identity for customer due diligence (CDD). While we urge FATF to finalize the guidance with the risk-based approach and the stated objectives, we urge further guidance to national-level regulators to focus on effectiveness of any system and to avoid imposing overburdensome requirements out of an abundance of caution.

We support the risk-based approach as it allows for flexibility to tailor a particular system to an individual country's regulatory framework or an individual financial institution. However, often times with risk-based approaches, prudential regulators look to impose only the highest standard and do not appropriately apply guidelines specifically tailored to credit unions, cooperative institutions and smaller, less

[1] Financial Action Task Force, *Public consultation on FATF draft guidance on digital identify* (November, 2019), *available at: https://www.fatf-gafi.org/publications/fatfrecommendations/documents/consultation-digital-id-guidance.html.*
[2] World Council of Credit Unions, *2018 Statistical Report* (2019), *available at* http://www.woccu.org/publications/statreport.

capitalized institutions. As such, we urge further implementation of guidance directing supervisors to consider some high level principles such as whether an institution has cross-border operations, the asset size, the institutions interconnectedness with the financial system, the degree to which they report to multiple prudential supervisors, the mix of business activities, the average level of transactions that occur in any account and that further corresponds to the size, and the complexity and risk of a financial institution. This will help alleviate the imposition of requirements that exceed the risk of the institution.

Prudential regulators often are overly conservative in their tolerance for risk for fear of something unforeseen occurring. This often creates unnecessary burdens for their regulated entities. The elimination of all risk is not the goal, but instead achieving effective risk management is the desired result that will help alleviate this issue. The result is that this approach will ultimately encourage financial inclusion, promote confidence in the numerous national systems of cooperative credit, and allow credit unions and other community-based cooperatives to mare readily serve underserved and unbanked populations.

We also further urge FATF to encourage prudential regulators to authorize systems for use in Customer Due Diligence. This allows the financial institution to rely on a system without the need to engage in extensive analysis that can be scrutinized by a regulator. However, we caution that regulators do not insist that any particular or narrow system be required as that can be prohibitive for smaller institutions.

Credit unions seek to increase underserved individuals' income and assets by giving them access to low-cost credit union financial services. Additionally, 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.

Credit unions engage in a variety of outreach activities to unbanked groups, such as bringing credit, savings, and remittance services directly to people living in remote rural areas, offering electronic and mobile banking products, "matched savings" programs designed to promote healthy savings habits, programs to encourage poor women to join credit unions, and so forth. Regulatory requirements on anti-money laundering (AML) can, however, prevent some individuals from being permitted to hold an account at a credit union or bank, and are often difficult and expensive for credit unions to comply with. World Council therefore supports FATF in developing a strong and clear risk-based approach to help credit unions and other small institutions promote financial

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inclusion of unbanked individuals, but also encourages clear guidance to national level regulators on the implementation of this approach.

Are there any specific money laundering/terrorist financing risks that arise from the use of digital identity systems for CDD, other than those already mentioned in Section IV of the guidance?

a. *If so, how can they be addressed and by whom? Are there specific opportunities for combatting money laundering / terrorist financing that are not already mentioned in the guidance?*

We concur largely with the risks identified in the guidance. We also note that one of the challenges faced by our members operating in underserved areas or rural areas is the lack of proper documentation. Lack of proper documentation is cited by 20% of the unbanked population as a significant barrier to opening a financial account. This not only makes it a challenge to serve these members, something that the development of a robust digital identity system can help address in the future, but it also is a source for risk in the system with the ability for the proliferation of fraud, identity theft, and other nefarious methods. This risk can be alleviated at the financial institution level by allowing them to set limits on transactions or account balances to minimize the potential for use for illegal purposes. As the institution gains experience and longer-term relationships, these levels can be raised.

Second, privacy laws, while important for consumer protection purposes, also can form a barrier to the ability of a financial institution to verify the identity of a person. Allowing increased information sharing for legitimate banking purposes will help alleviate this issue.

What is the role of digital ID systems in ongoing due diligence or transaction monitoring?

If digital ID systems can be integrated into the core system of a financial institution and in a cost-effective manner, they can be used throughout the life of the banking relationship, for example, allowing reverification at a teller window. As accounts are reviewed periodically, the information can provide additional due diligence on the member or even help identify red flags during the monitoring process.

a. *What information do you capture under authentication at on-boarding and during authorisation for account access? Who captures this data?*
b. *Is the authentication data you capture relevant to ongoing anti-money laundering and counter terrorist financing due diligence and/or transaction monitoring? If yes, how?*

World Council represents many credit unions worldwide who vary in size, complexity, and policy and protocol. It is difficult to represent a solitary answer for

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onboarding and account access practices for all frameworks. Generally speaking, the data collected can vary but will include the members static data and identifying documents, signature or electronic signature (if available by the system), verification documents, and other account opening documents. For credit unions this can include membership documents for purposes of joining the credit union. Digital ID systems can often be a challenge for credit unions as sometimes local regulations require in person visits to the institutions. In the Ukraine, for instance, their credit unions do not us digital id systems during the onboarding and account access stages because they do not provide online services. In order to open an account, customers are required to personally go to a physical credit union branch and provide a passport or national ID, their tax code, and complete an application. Part of the application does illicit information as required by state level authority AML regulations.

How can digital ID systems support financial inclusion?

As previously stated, credit unions operate on a not-for-profit, member-owned and controlled cooperative basis, therefore giving individuals of more modest means a greater opportunity at financial inclusivity than larger banks. Credit union members usually live and/or work in the local community where the credit union's office or offices are located. Many credit unions are very small (often having less than US$ 1 million in assets), are partly and at times entirely run by volunteers, and are typically governed by an unpaid board of directors. Some directors and executives are fairly (not lavishly) compensated. The directors and executives are the hallmarks of the cooperative structure that boosts the member benefits.

Credit unions' service to working people of modest means allows them to act as a buffer against usurious money lending practices that hinder asset accumulation. These institutions frequently have limited capacity to deal with detailed and prescriptive regulations but are nonetheless essential to promoting financial inclusion in their local, often rural, communities.

Members receive credit at interest rates that are frequently lower than the prevailing market rates, regardless of how small the loan. In addition to providing affordable credit, credit unions foster systematic savings and help members in the management other their money. Supervisory bodies that are supportive of these principles encourage the growth of credit unions through proportional regulation. We believe that due to the cooperative structure of credit unions, their not-for-profit tax status, and the benefits they provide their members as well as the benefits they provide to society, stringent requirements for AML/CFT digital identity systems should not be imposed on credit unions.

World Council expressly supports the use and incorporation digital ID technology and maintains many development programs working to implement new technologies that

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will allow credit unions to provide access to financial services to under-banked and non-banked individuals and communities. For example, some of our development projects provide financial services to communities in rural areas through their cell phones by way of a mobile application. World Council strongly supports guidelines and regulations that are tailored toward smaller institutions such as credit unions, in order to perpetuate continued support to developing and underserved communities.

However, the other side of digitization is that the cost associated with these technologies can often be prohibitive for a smaller institutions to afford. The risk-based approach which allows for tailoring to the size and complexity can help allow for the development of these systems that are affordable.

a. *How can digital ID systems with different assurance levels for identity proofing/enrolment and/or authentication be used to implement tiered CDD, allowing clients a range of account functionalities depending on the extent of CDD performed, and particularly in situations of lower risk? Please provide any practical examples.*

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 you 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. Credit unions often have limited financial and staff resources because of the relatively small size of their assets, as such, regulatory burden is a significant issue for credit unions. Tiering of CDD to allow for a range of account functionalities would benefit credit unions as this would likely result in systems more appropriate for their size and complexity and likely allow for less expensive systems to be developed.

b. *Have you adopted lower assurance levels for identity proofing to support financial inclusion? What additional measures do you apply to mitigate risks? Please provide any practical examples.*

Credit unions have adopted lower assurance levels for identity proofing that fit within prescribed regulations and directives, however, AML/CFT laws have still proven to be stringent on both their resources and finances, or alternatively, regulators have been reluctant to allow their use. 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 regulators to mitigate risks even though the risks are not evident. Credit unions assets are much smaller than banks, and the credit services and loans are typically small and easily

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managed. They do not rise to the level of AML regulated limitations on aggregation amounts, so any additional preventative measures could be onerous or cost prohibitive to implement.

c. *How can progressive CDD via digital ID systems aid financial inclusion (i.e. establishing greater confidence in a customer's identity over time)?*

Progressive CDD has the ability to assist smaller financial institutions implement digital identity solutions as the requirements can be better tailored to their size and complexity, thus reducing implementation costs and procedural burdens.

Does the use of digital ID systems for CDD raise distinct issues for implementing the FATF record-keeping requirements?

a. *What records do you keep when you use digital ID systems for CDD?*
b. *What are the challenges in meeting record-keeping requirements when you use digital ID systems for CDD?*
c. *If you keep different records when using digital ID systems for on-boarding, does this impact other anti-money laundering and counter-terrorist financing measures (for example ongoing due diligence or transaction monitoring)?*

For credit unions, most national level AML/CFT require proper recordkeeping to demonstrate compliance with the regulations. In addition, recordkeeping, record retention and record destruction is a part of this system. Ideal digital ID systems will allow integration with these requirements, however, for smaller institutions this often requires specialized programming to integrate these systems properly and seamlessly.

Conclusion

In the past, FATF has provided numerous examples of national AML rules allowing for simplified CDD measures, which benefit cooperative structures such as credit unions. World Council recognizes that FATF has participated in a detailed discussion regarding lower-risk CDD scenarios, as outlined in the FATF Guidance on Anti-Money Laundering and Terrorist Financing Measure and Financial Inclusion, as such, we stand behind these efforts and believe our input will help foster the principles set forth in the aforementioned guidance. Furthermore, World Council strongly supports FATFs guidance on digital identity, and we appreciate your considerations given to financial inclusion. We believe that guidelines that allow for solutions tailored proportionally to the size, risk, and complexity of smaller, less intricate financial institutions will ensure your mission to bolster financial inclusion while maintaining an effective risk-based approach to the use of digital identification for customer due diligence.

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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,

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