Summer School 2022
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Financial Inclusion
Comparing regulatory choices

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LEGEND
- Mobile / Internet
- Cloud Computing
- AI, ML, Big Data
- Blockchain
- Internet of Things (IoT)

	New Business Models / Financial Products	Technology / Products	Examples of Key Benefits	Examples of Key Challenges/ Risks
Payments	Mobile Money - P2P Transfers		Simple, more reliable, cost effective, and faster than other methods Can help lift people out of poverty	Fraud risk from agents Lack of interoperability Relatively low active usage rates
Payments	Digital Payments & Remittances		Lower costs, higher transparency, and higher privacy Significant savings in time and travel costs	Data security risks Providing personal information which can be lost or stolen
Lending	Credit Risk Assessment		Access to loans, which was not possible with traditional credit risk assessment models	May create gender bias and/or income inequality Spurious correlations from the data
Lending	Alternative Lending / P2P Lending	+ 2 + 3	Access to loans to unbanked and underbanked Faster and more efficient	Higher borrowing costs when compared to bank loans Risk of over-indebtedness
Savings & Insurance	Digital Savings		Lower costs, increased liquidity, and higher transparency Lower risk of theft	Significant customer financial capability required Regulation / protection of the float
Savings & Insurance	Digital Insurance	+ 2	Lower costs, increased liquidity, and higher transparency Faster and more efficient	Significant customer financial capability required

Source: UNSGSA FinTech Working Group and CCAF (2019)

GLOBAL PARTNERSHIP FOR FINANCIAL INCLUSION (GPFI)

- **G20 High-Level Principles for Digital Financial Inclusion, 2016**
- **G20 2020 Financial Inclusioni Action Plan, 2020**
- **Global Standard-Setting Bodies and Financial Inclusion - The Evolving Landscape, 2016**

G20 HIGH-LEVEL PRINCIPLES FOR DIGITAL FINANCIAL INCLUSION, 2016

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PRINCIPLE 1: Promote a Digital Approach to Financial Inclusion

Promote digital financial services as a priority to drive development of inclusive financial systems, including through coordinated, monitored, and evaluated national strategies and action plans.

PRINCIPLE 2: Balance Innovation and Risk to Achieve Digital Financial Inclusion

Balance promoting innovation to achieve digital financial inclusion with identifying, assessing, monitoring and managing new risks.

PRINCIPLE 3: Provide an Enabling and Proportionate Legal and Regulatory Framework for Digital Financial Inclusion

Provide an enabling and proportionate legal and regulatory framework for digital financial inclusion, taking into account relevant G20 and international standard setting body standards and guidance.

PRINCIPLE 4: Expand the Digital Financial Services Infrastructure Ecosystem

Expand the digital financial services ecosystem—including financial and information and communications technology infrastructure—for the safe, reliable and low-cost provision of digital financial services to all relevant geographical areas, especially underserved rural areas.

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PRINCIPLE 5: Establish Responsible Digital Financial Practices to Protect Consumers

Establish a comprehensive approach to consumer and data protection that focuses on issues of specific relevance to digital financial services.

PRINCIPLE 6: Strengthen Digital and Financial Literacy and Awareness

Support and evaluate programs that enhance digital and financial literacy in light of the unique characteristics, advantages, and risks of digital financial services and channels.

PRINCIPLE 7: Facilitate Customer Identification for Digital Financial Services

Facilitate access to digital financial services by developing, or encouraging the development of, customer identity systems, products and services that are accessible, affordable, and verifiable and accommodate multiple needs and risk levels for a risk-based approach to customer due diligence.

PRINCIPLE 8: Track Digital Financial Inclusion Progress

Track progress on digital financial inclusion through a comprehensive and robust data measurement and evaluation system. This system should leverage new sources of digital data and enable stakeholders to analyze and monitor the supply of—and demand for—digital financial services, as well as assess the impact of key programs and reforms.

PRINCIPLE 3- PROVIDE AN ENABLING AND PROPORTIONATE LEGAL AND REGULATORY FRAMEWORK FOR DIGITAL FINANCIAL INCLUSION

- **Provide an enabling and proportionate legal and regulatory framework for digital financial inclusion, taking into account relevant G20 and international standard setting body standards and guidance.**

- **If digital financial inclusion is to develop and expand in a sustainable way, providers and other market participants need a legal and regulatory framework that is: *predictable*, *risk-based* *and* *fair*; *allows for new entrants*; *and does not impose excessive, non-risk-based compliance costs*.**
- **In particular, the framework should reflect a careful assessment of the relevant risks from market, provider and consumer perspectives; provide clear market participation rules; establish a fair, and open, level playing field for market participants; and ensure a framework that can be effectively and efficiently supervised with the requisite supervisory capacity and resources. The willingness to innovate and invest will be undermined without such a legal and regulatory approach, as will be the potential opportunities for financially excluded and underserved groups to access financial services. In addition, risks may not be adequately addressed.**

Examples of key actions to develop an enabling and proportionate legal and regulatory framework include, but are not limited to, the following:

- **(1) Implement a framework for digital financial inclusion that provides for market participation (including entrance requirements), prudential requirements where appropriate (e.g., for capital and liquidity), market conduct and integrity, consumer protection, AML/CFT safeguards, and insolvency. Such a framework should be technology-neutral and flexible enough to cover both new and existing service providers and product innovations (for example, through a broad definition of regulated digital financial providers and services which can be amended over time).**

Examples of key actions to develop an enabling and proportionate legal and regulatory framework include, but are not limited to, the following:

- **(2) This framework should also allow for piloting innovative new delivery channels, products and services, and business models, without having to immediately comply with all regulatory requirements. At the same time, such a framework should ensure fair and balanced oversight, maintaining obligations to meet AML/CFT requirements consistently with international standards, while ensuring that no participant in the pilot obtains an undue advantage. And the framework should balance the risks of digital financial inclusion with the costs of supervision and compliance.**

Examples of key actions to develop an enabling and proportionate legal and regulatory framework include, but are not limited to, the following:

- **(3) Promote competition and a fair, and open, level playing field for digital financial inclusion by ensuring that providers of similar digital financial services have similar rights and responsibilities regardless of their institutional type and the technology used. There should also be clear and consistent criteria for market participation (including for new and foreign entrants) and for offering specific types of digital financial services. This framework also should ensure that similar risks are regulated in a similar manner and that an appropriate risk-based approach to supervision is developed.**

Examples of key actions to develop an enabling and proportionate legal and regulatory framework include, but are not limited to, the following:

- **(4) Assess all areas of national and local law relevant to digital financial inclusion to identify and address areas of overlap or contradiction as well as any gaps, barriers to access, or other obstacles. These areas may include:**
- **financial services, payments systems, telecommunications, competition, discrimination, identity, barriers to excluded and underserved groups accessing digital financial services, and responsibility for agents and employees.**

Examples of key actions to develop an enabling and proportionate legal and regulatory framework include, but are not limited to, the following:

- **(5) Ensure a clear delineation of responsibilities among regulators for the legal and regulatory framework relevant to digital financial services and for digital financial inclusion in general.**

Examples of key actions to develop an enabling and proportionate legal and regulatory framework include, but are not limited to, the following:

- **(6) Build the capacity of supervisors of the legal and regulatory framework for digital financial inclusion to understand digital technologies (for example through local and international training and peer learning programs) and encourage the use of digital technologies, as appropriate, to improve their processes and capacity for supervision.**

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Examples of key actions to develop an enabling and proportionate legal and regulatory framework include, but are not limited to, the following:

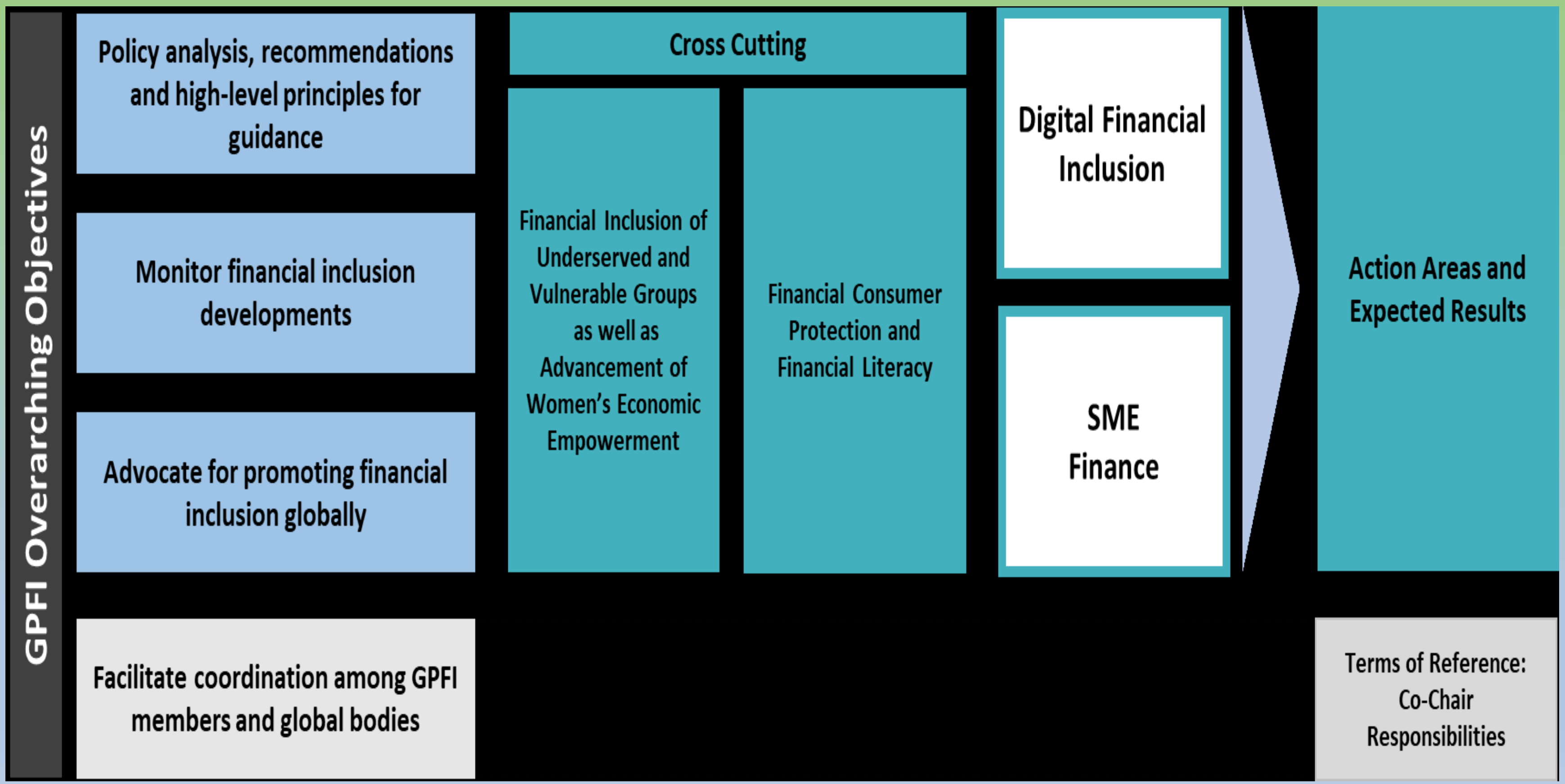
- **(7) Draft laws, regulations, and guidance relevant to digital financial inclusion in a plain and easy to understand manner, and make them easily available to industry and consumers (for example, through a publicly accessible website and other accessible channels of communication).**

Examples of key actions to develop an enabling and proportionate legal and regulatory framework include, but are not limited to, the following:

- **(8) Establish a sustainable mechanism among G20 members for regular**
- **communication and information exchange on digital financial inclusion**
- **legal and regulatory frameworks and related supervisory approaches,**
- **including risk management strategies and experiences.**

G20 2020 FINANCIAL INCLUSION ACTION PLAN, 2020

2020 G20 Financial Inclusion Action Plan Framework



GLOBAL STANDARD-SETTING BODIES AND FINANCIAL INCLUSION - THE EVOLVING LANDSCAPE, 2016

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Considering Country Context

Observations

- **For some EMDEs with high levels of financially excluded and underserved households and micro, small, and medium enterprises, full compliance with current SSB standards may be a long-term goal. In such contexts, SSB guidance needs to accommodate widely varying financial market structures (especially with the advent of digital financial inclusion, introducing new non-bank actors including non-financial firms) as well as varying levels of policymaking, regulatory, and supervisory capacity**

Concept of Proportionality Applied to Financial Inclusion

Observations

There is broad consensus among SSBs that proportionate application of global standards is important for financial inclusion. This is reflected in revisions of standards to embed the concept in an overarching way. The current challenge is to determine how far global SSBs can go towards specifying "proportionality in practice", as this entails different approaches across jurisdictions (given varying country contexts) and across service providers (especially considering the evolving landscape of digital financial inclusion). Across all the SSBs—as well as the GPFI and its Implementing Partners and other global bodies such as IMF—there are myriad examples of analytical work aimed at deepening thinking about the potential for a proportionate approach to financial sector policymaking, regulation, and supervision to contribute both to financial inclusion and financial stability, as well as to the linked objectives of financial integrity and consumer protection. The risks of financial exclusion also merit consideration in this context.

PAYMENT SYSTEM REGULATION
FOR IMPROVING FINANCIAL INCLUSION

1. FOCUS ON TECHNOLOGY: REGULATION OF INNOVATIVE PAYMENT INSTRUMENTS OR PRODUCTS

There have been two trends identified as being followed by regulators to tackle innovation

The so-called “ex-ante approach”, i.e., tackling the issue of provision of innovative payment instruments directly, by introducing general categories

This first approach is that followed by the European Union (EU) in the adoption of the 2000 E-Money Directive, where criteria were established ex ante to issue an e-money product. This example teaches us some useful lessons. While representing one of the first attempts to regulate the matter through a general and technology neutral approach, it also showed a number of inherent shortcomings, to the point that the EU Commission in 2009 had to substantially amend the Directive

The so-called “ex-post approach”, i.e., to proceed step by step, in conjunction with the introduction of new products in the market, and regulate new instruments once they are launched in the market and the risks in their operational features have emerged

Among countries having followed this second approach, Indonesia and India are amongst the most interesting. However, both appear to have slightly modified their approach when the market matured.

There have been two trends identified as being followed by regulators to tackle innovation

The ex-ante approach has the advantage of broadly defining the features (of potentially more instruments and products) it intends to cover in general, under a technologically neutral approach. This would avoid different treatment of instruments which are potentially in competition, and directly address the issue of risks inherent in each feature and/or function as a general category.
− However, the aim of defining general categories could result in too abstract a definition of identifying or qualifying relevant features. This increases the risk of lacking adequate regulation for any foreseeable ramifications of a similar feature or market development, and could possibly result in higher regulatory density, making the overall regulatory environment inadequate for the concrete needs of a specific context.

The ex-post approach reacts more specifically to the individual features of an instrument, and permits the regulator to adapt its policies to the circumstances.
− However, this is not technologically neutral and thus might easily generate regulatory discrimination, as well as result in fragmented, or to some extent redundant, regulation. Another consequence is that this approach might also potentially hamper innovation. Moreover, being an ex post approach, it would by definition always intervene once the product has entered the market. In a context where technology advances at an extremely rapid speed, the concrete risk is that regulation addresses situations that have already been overcome by new technologies. Regulation would continuously strive after business advances and result in piece-meal approaches

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However, the difference between an ex-ante and an ex-post approach should not be over-emphasized

Pros and cons in both approaches. **Besides the fact that both have specific advantages and disadvantages, and have proved to have potential shortcoming in concrete regulation of innovation, these are strongly dependent on the institutional and regulatory context in which they are adopted.**

Combined approach**. A combination of the two could instead provide adequate results. High-level principles could be established using general measures covering the generality of instruments, services or products, and be tailored with some flexibility left to the regulatory authority to implement such high-level principles in concrete situations, and to adapt to the progressive modernization of the market.**

Australia could be considered a benchmark for such a "combined approach": this is one of the first countries to have adopted legislation on payments, and one of the few which recognizes a high level of flexibility to the Central Bank as far as authorization of individual providers and instruments. General statutory definitions are thus implemented according to actual products characteristics in the market according to Central Bank evaluations and policy decisions

2. FOCUS ON SERVICE PROVIDERS: REGULATION OF NON-BANK OPERATORS

Those countries that have, at least initially, made the choice of directly focusing on technological innovation in their regulatory policies to address the new retail landscape, have all been obliged at some point to also address the issue that provision of innovative payment instruments implies an important role for non-bank operators:

Payment exclusively as a banking activity by law. **The choice to allow payment services only to banks may be forced. This occurs in cases where domestic legislation on banking explicitly includes the provision of payment services within the sole domain of banks, as in Cambodia. This restraint could be overcome only by statutory amendment to the relevant legislation.**

Payment services as a regulated activity open to any operator so authorized. **In other countries, the legislation on banking is ambiguous, in the sense that execution of money or payment transfers is not specifically mentioned as an exclusive prerogative of banks. In this case, it is up to the regulators to decide which entities should be allowed to provide payment services. See EU (further slide below)**

Leaving payment services as an unregulated commercial activity. **The choice of the EU and countries having followed similar paths has been to regulate non-banks providing payment services. This opens the market, but still ensures it is regulated. This approach has proven effective, since it permitted a balanced consideration of both efficiency and competitiveness of the market, on the one side, and safety, on the other. Once a domestic legislation does not make payment services a prerogative of banks, however, it might also be assumed that any commercial entity can freely provide such service. This was for instance the original approach in Kenya when M-Pesa entered the market**

European Union

- The EU approach was originally that of regulating the market by institution. First it regulated credit institutions, then institutions only providing e-money (EMI), and finally institutions generally providing payment services (PI).

– However, the latest standards, as established by the 2007 Payment Services Directive (PSD), and then confirmed by the 2009 E-money Directive rely on functions performed by each institutions.

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European Union

More precisely:
a) the PSD regulates payment services, and then establishes that such services can be provided by either credit institutions or PI;
b) PI, on their side, need to respect requirements concerning initial capital, at different levels according to the kind of services performed, and also for on-going capital (own funds), to be calculated under three different methodologies to permit some flexibility;
c) on the other hand, the main difference between a PI and an EMI is that the latter offers payment services by way of store-value devices. This implies the imposition of additional requirements and restrictions (in particular for the protection of customers' funds and mitigation of insolvency risk) by the E-Money Directive, which for the rest simply refers to the PSD.

M-Pesa in Kenya

- The product was introduced to the market without the need for any specific license or authorization. Nor was this “designated” under a different mechanism such as those that can be found in countries where payment instruments are somehow assimilated by payment systems.
Many commentators attribute the success of M-Pesa to this element (the lack of regulation), although others elaborate on the analysis and also consider the traditionally low penetration of the banking sector in Kenya.

− Today the regulatory landscape in Kenya has completely changed because of new legislation (2011), which also presents a number of elements of extreme interest.

M-Pesa in Kenya

- The Act is indeed quite articulated and covers all main components of a national payment system.

In particular, it provides for a) designation of payment systems, b) designation of payment instruments; and c) authorization of payment service providers. The definition of both payment instrument and payment service provider is apt to cover any possible means and activity to transfer money. In addition, whereas authorization of payment service providers is subject to compliance with a number of prudential and regulatory standards and is needed by any operator intending to enter the market, designation of payment instruments only occurs when the Central Bank of Kenya (CBK) is of the opinion that a) the instrument is of widespread use and consequently may affect the payment systems in the country, b) the designation is necessary to protect the interest of the public, or c) such designation is in the interest of the integrity of the payment instrument. Designation implies subjection to those criteria that the CBK might decide in light of each specific case.

M-Pesa in Kenya

The National Payment Systems Regulations, (2014) then elaborate on many issues, such as agents and cash merchants, outsourcing, interoperability, and risk management.

It appears clear how the new regulatory framework of Kenya has turned from nothing into one of the most articulated regulatory systems in the world. It established, on the one hand, a general regime for payment service providers, which are defined as regulated entities, and subject to conditions that are meant to be consistent with those of banks in order to ensure a level playing field, and, on the other hand, a designation mechanism for systems and instruments that leave the CBK room for flexible solutions according to the concrete situation.

3. PRO-ACTIVE REGULATIONS FOR FINANCIAL INCLUSION

Gradual measures to enlarge service providers and instruments, and lower regulatory constraints.

Colombia, Brazil and Mexico are specific examples among the many countries where central banks and banking supervisors take into consideration financial inclusion in the establishment of their general policies.

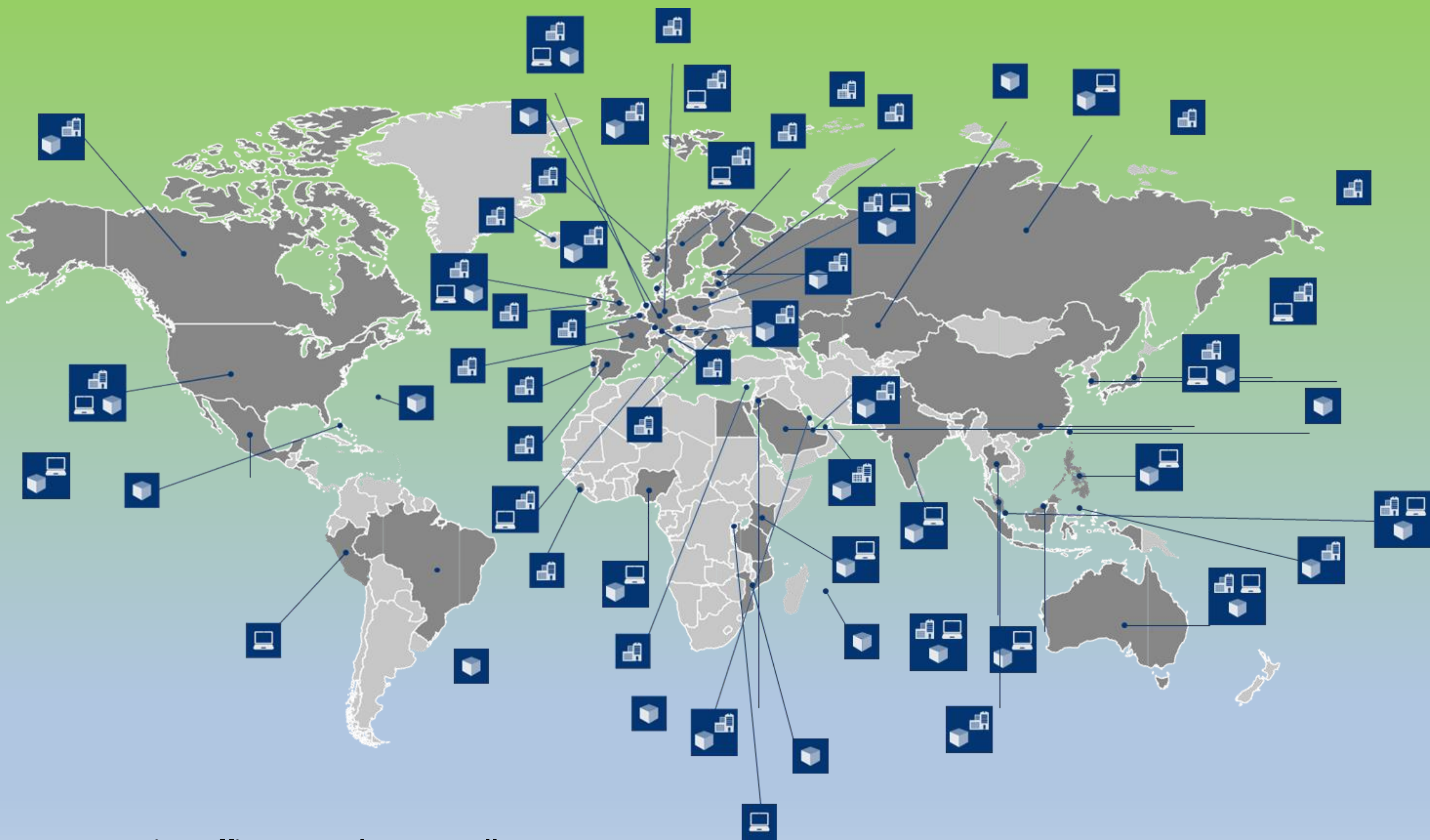
The approaches followed by Brazil and Colombia were to favor financial inclusion by adopting gradual measures of enlargement of service providers and instruments, on the one hand, and by lowering regulatory constraints, on the other. In both cases, following the successful implementation of the scheme of banking correspondents (non-banks providing some banking services, in particular related to payments, on behalf and in the name of banks), they moved to a system which allowed for direct provision of payment services by non-banks.

Mexico, on the other hand, has recently actively intervened to encourage financial inclusion. In 2011, financial authorities, including the Ministry of Finance (SHCP), the National Banking and Securities Commission (CNBV) and the Bank of Mexico, issued regulations that allow banks to establish schemes to facilitate financial inclusion via cooperation with non-banks. This regulation also allows users to open low-risk banking accounts remotely (via a phone call or the internet) with the provision of basic identification information. Such accounts have limits on monthly deposit amounts and may be linked to the user's mobile phone number, allowing the mobile phone to serve as a channel for payment instructions. The 2011 regulation was followed by new amendments and provisions regarding mobile payments, which were issued by Bank of Mexico at the end of 2013

The combination of enabling regulatory measures conducive to innovation and modernization, and of more pro-active actions

The approach of RBI in India is much more pervasive than those just described. In particular, the RBI 2012-2015 Vision Statement for payment systems shows a combination of enabling regulatory measures conducive to innovation and modernization, and of more pro-active actions, directly intervening on specific aspects such as pricing. This was designed to address efficiency and safety as a main concern, yet also intervene when the market did not reach the projected goals. This is an articulated plan in which the continuous monitoring of partial results by the RBI is a key component.

Examples of Innovative Regulatory Initiatives Around the World



Innovation Offices - Regulatory Sandboxes

RegTech for Regulators

Thank you for your attention!