Financial Regulations for Improving Financial Inclusion

Liliana Rojas-Suarez
Delhi, May 2016

Purpose of a Report linking Financial Regulations with Financial Inclusion

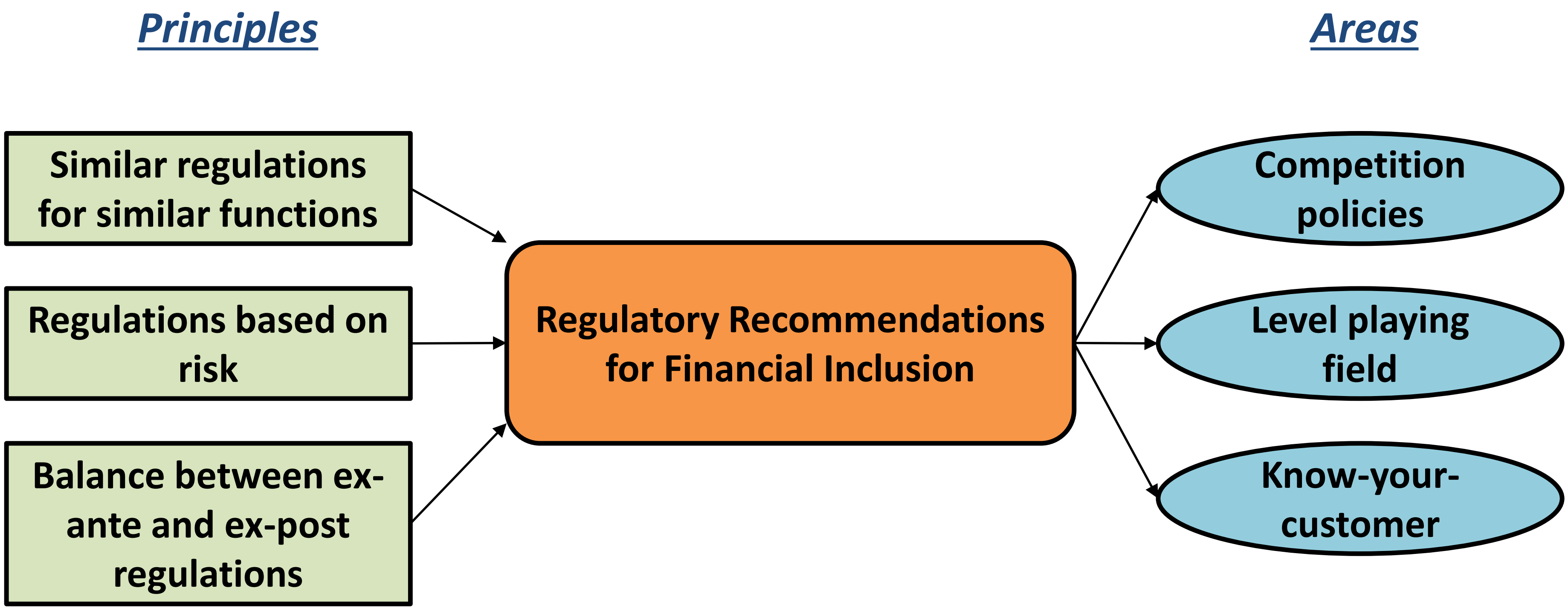
Improve Financial Inclusion (especially digital) through a Better Regulatory Framework.

Why the Emphasis on Regulation?

- As it is key to enable the private sector to successful adopt and adapt innovations in digital finance and encourage their use by low-income populations.

Pro-financial inclusion policies need to be compatible with the traditional mandates of financial regulation: stability and integrity of the financial system, and consumer protection.

Foundation of the Recommendations



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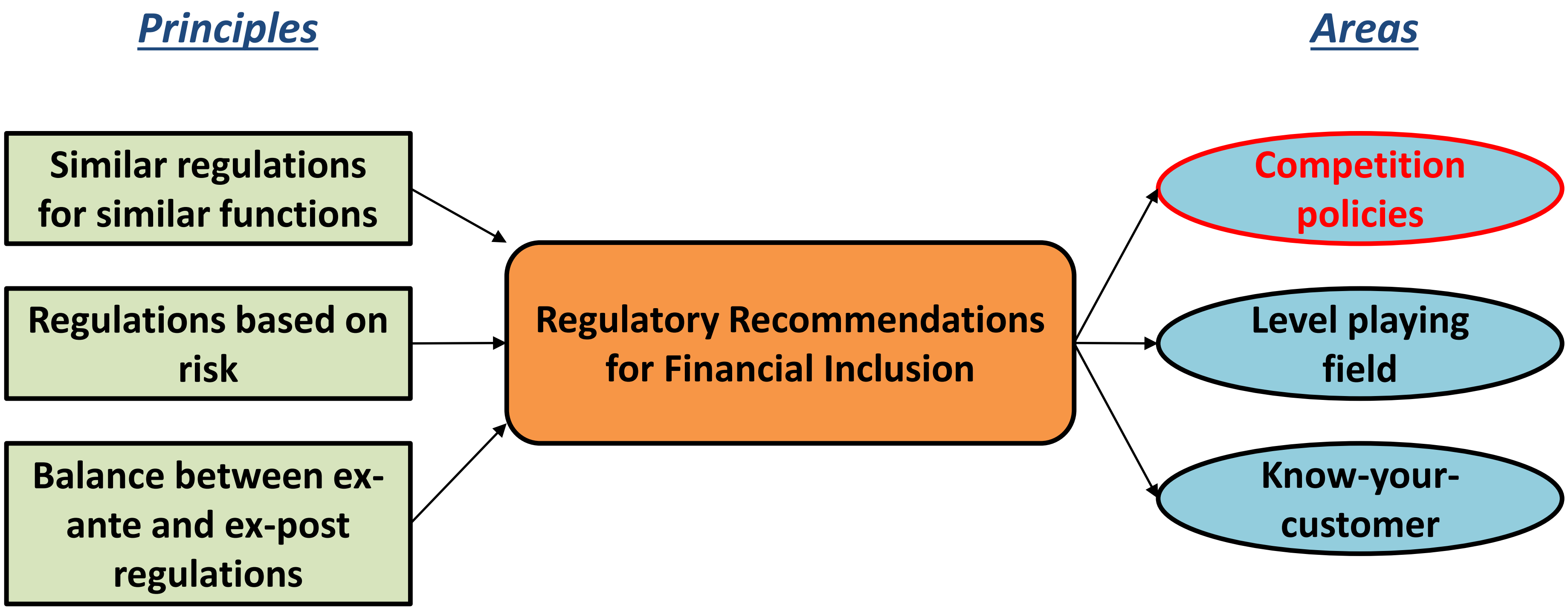


Competition Policy

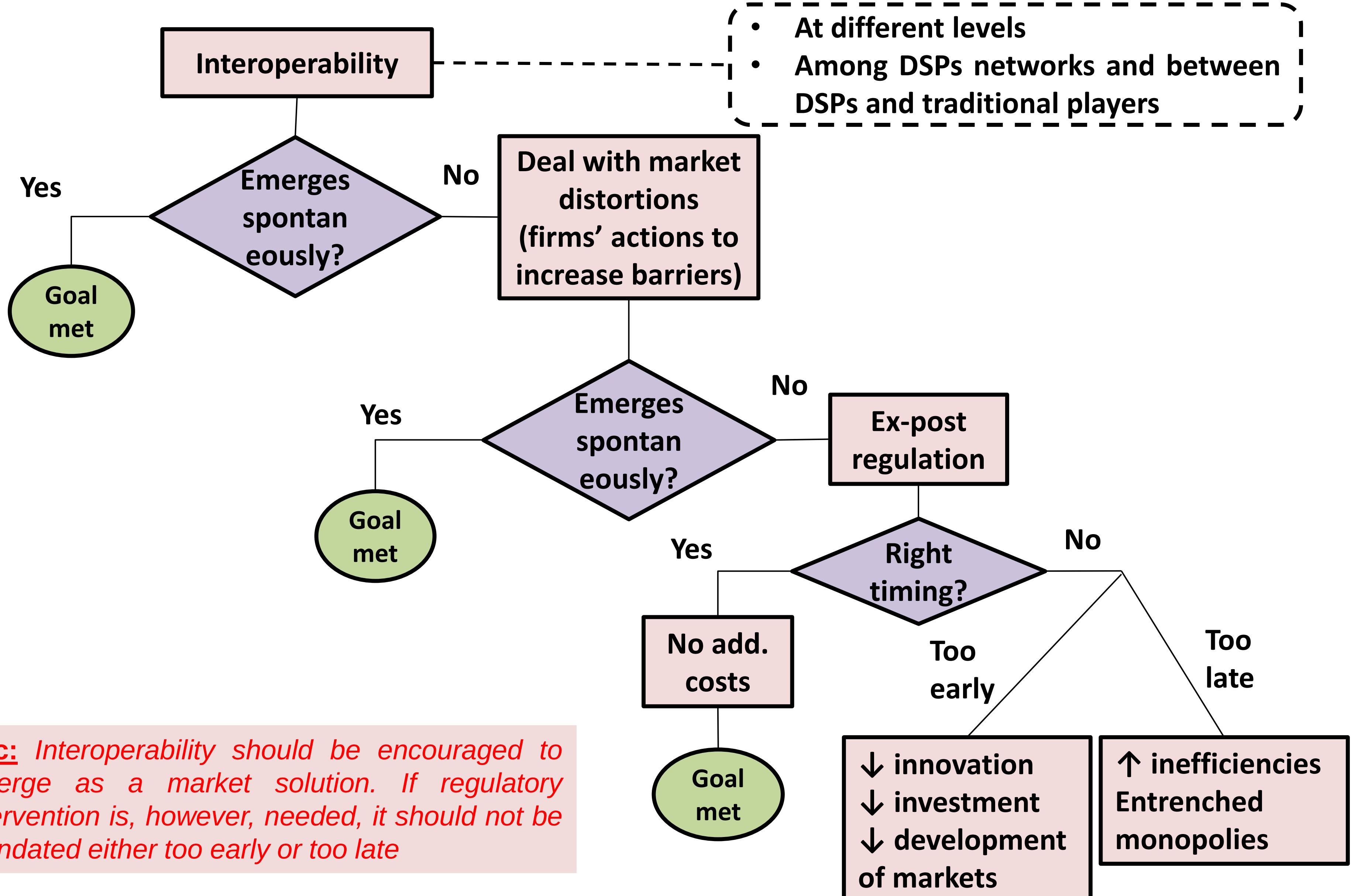
Matters greatly for financial inclusion, especially in developing countries, because:

- Markets open to fair competition more likely expand to include potential consumers currently on the sidelines
- Helps ensure that the financial industry increase efforts to identify the needs of the underserved

The Goal:

- Allow and encourage entry of new, **qualified** providers of financial services, without deterring or precluding useful cooperation among them.

Competition Policy: Examples of recommendations



Rec: *Interoperability should be encouraged to emerge as a market solution. If regulatory intervention is, however, needed, it should not be mandated either too early or too late*

Competition Policy: Country Experiences

Interoperability as a market solution in Tanzania

- IFC facilitated an industry-wide process for interoperability in the mobile payments market
- Regulator’s stated preference was for the market to reach interoperability on its own
- Airtel, Tigo, and Zantel agreed to interoperate and went live on September 2014. Vodacom joined in early 2016

Partial interoperability through ex post regulation in Kenya

- M-Pesa lacks full interoperability with the rival services offered by Airtel, Orange, and yuMobile
- Kenyan authorities were concerned about the high-level of agent exclusivity (before July 2014, 96 percent of agents were serving one provider exclusively)
- In July 2014, Safaricom opened up its M-Pesa agent network to rival Airtel just before the Competition Authority of Kenya ordered Safaricom to open up its network of 85,000 agents to rivals

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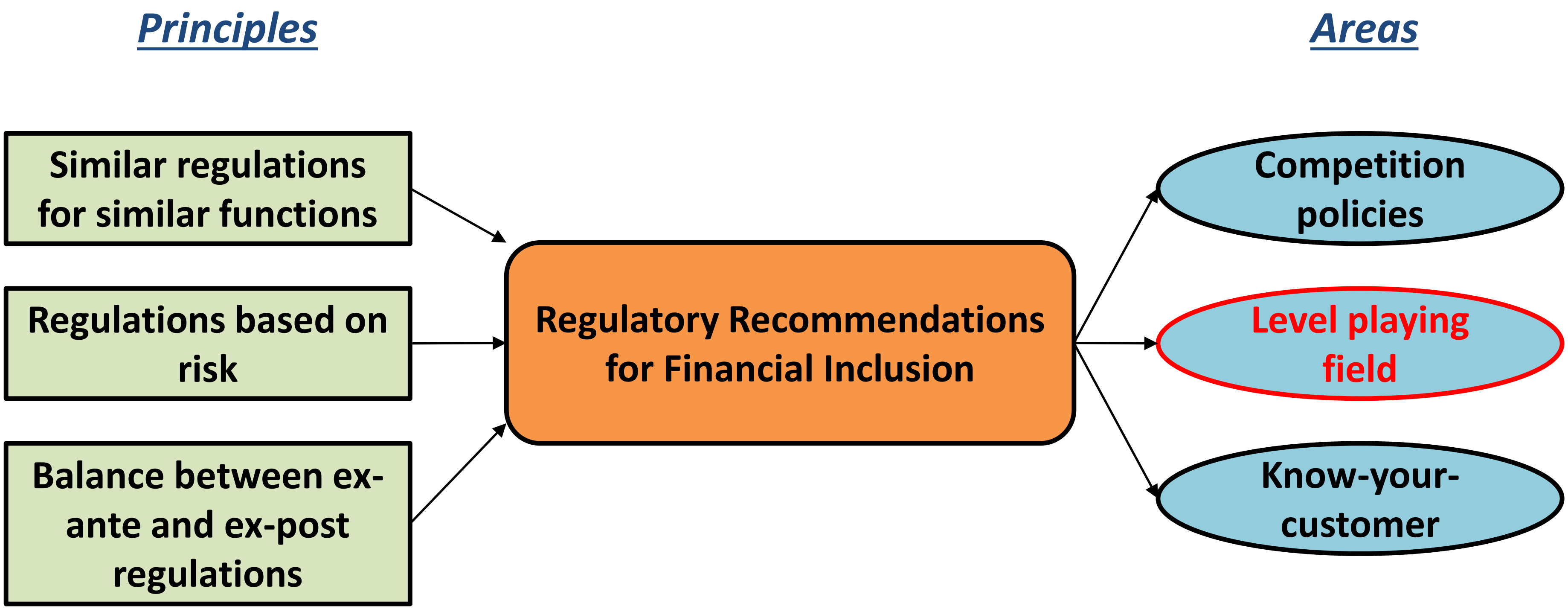


Leveling the Playing Field

Key for achieving digital financial inclusion because:

- Providers of digital financial services are often quite different one from another and follow different models, especially true of the newly emerging providers

- Financial services provided by different entities and related services important to digital financial inclusion, such as the various financial and telecommunications infrastructures, are likely to be covered by multiple regulators

The Goal:

- Prevent that regulations or regulatory actions create distortions (even if unintentionally), favoring some providers vs. others. To this end, ensure that functionally-equivalent digital services are regulated equally

Understanding Leveling Playing the Field

Indonesia: Unleveled regulatory framework undermines the growth of mobile money networks

- Despite Indonesia’s high mobile phone penetration and large volumes of G2P payments, only 36% of Indonesian adults have an account at a formal financial institution (Global Findex 2015)
- Indonesia’s regulations only permit big banks to hire informal, unregistered entities (mom & pop shops) as e-money agents
- Smaller banks and MNOs can only partner with registered legal entities
- Restricts MNOs and non-banks from building dense agent network in rural areas
- As a result, MNOs are struggling to scale up their operations

Understanding Leveling the Playing Field

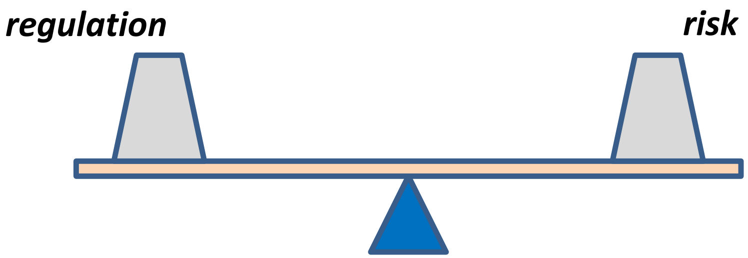
- **To level the playing field, the functional and the risk-based approaches can interact**
- **The functional approach calls for equal treatment for functionally similar services. But…**

	Service 1	Service 2	…	Service Y
Fin. Provider 1	●			
Fin. Provider 2	●			
Fin. Provider 3	●	●		
Fin. Provider 4	●	●	●	
…	●	●	●	
Fin. Provider X	●	●	●	●

Understanding Leveling the Playing Field

… even when providers offers the same service, regulatory requirements could differ across providers when risks vary. For example:

Store-of-value service
Backed by safe assets



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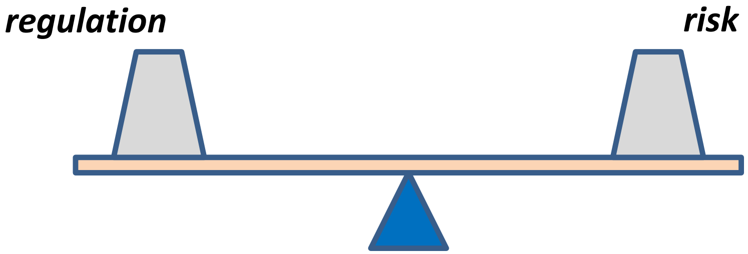
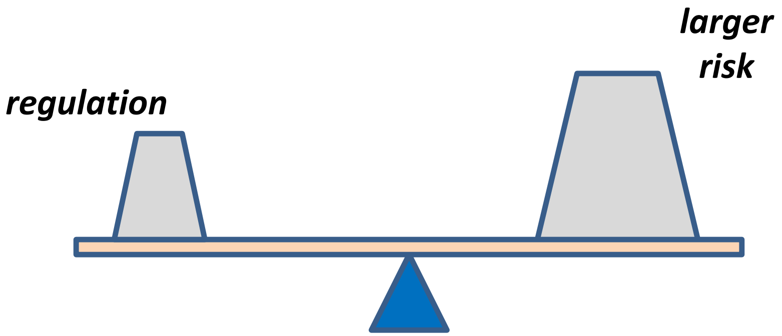


Store-of-value service
Not backed by safe assets



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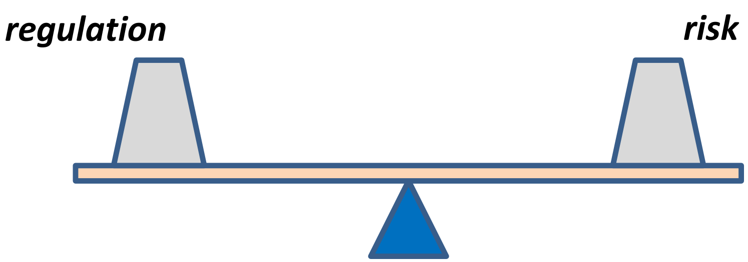

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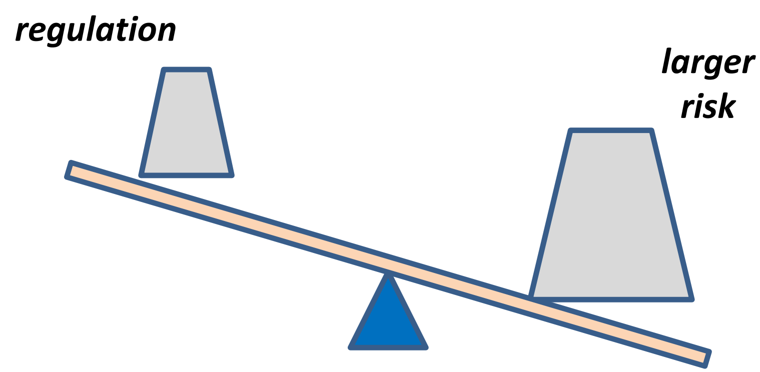

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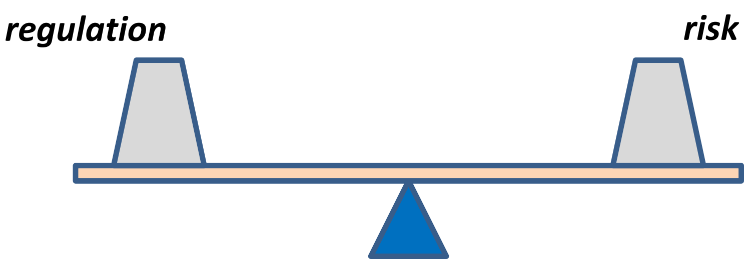

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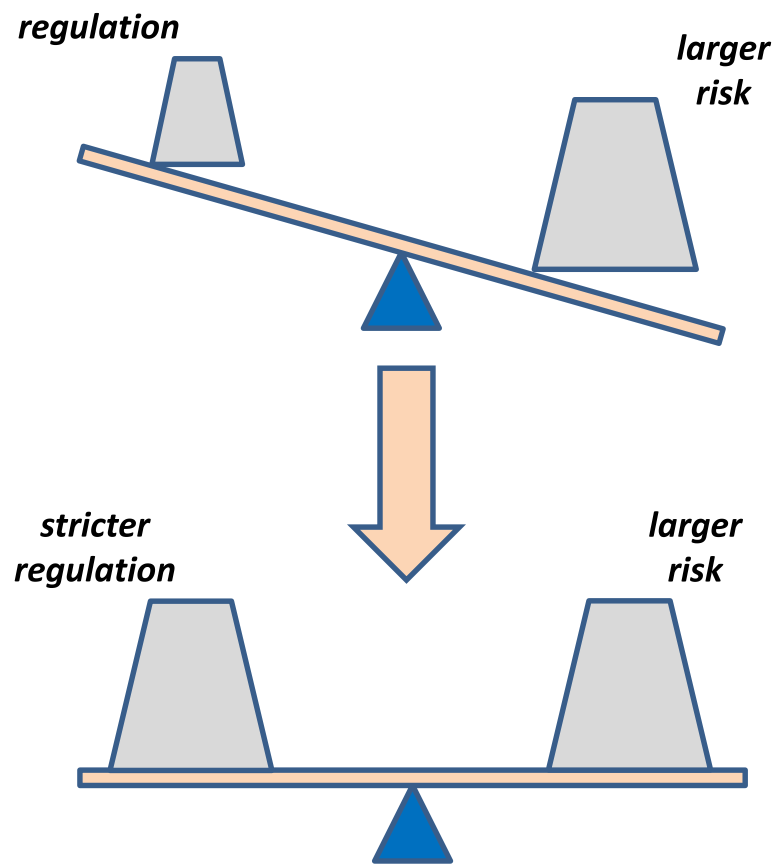


Leveling the Playing Field: Examples of recommendations

Additional Regulatory Requirements (as risks increase)

Providers of credit services

- For DSPs that use store of values to fund credit, additional regulations apply, typically similar to those applied to banks (capital, reserves and other prudential requirements) to protect the individual saver, the insurance provider (if the stored values are insured), and the stability of the overall financial system.

Providers of store-of-value services (not backed by safe assets)

- (Deposit) Insurance might be applicable to protect users
- Deposit insurance comes with limitations on the type and quantity of risky assets held by the financial Institution to reduce moral hazard and other concerns.

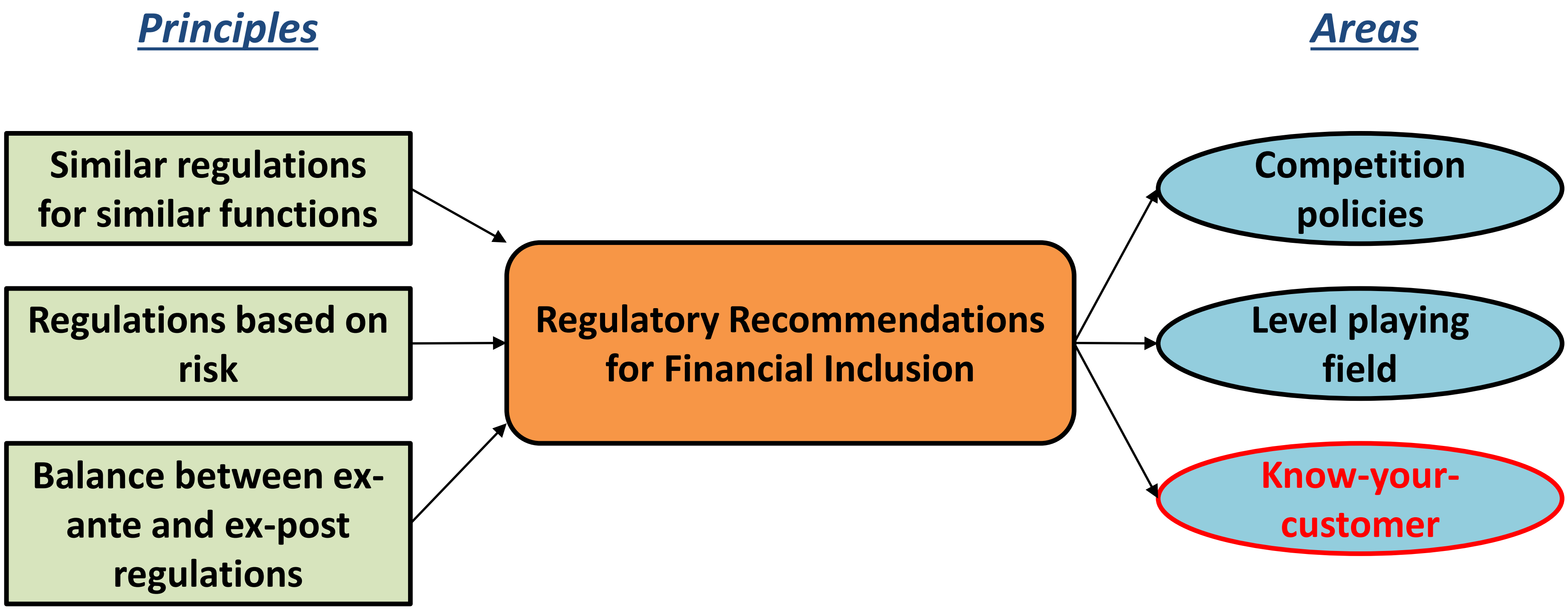
Providers of store-of-value services (fully backed by safe assets)

- For DSPs that go beyond simple payment transactions, increased requirements may apply (such as additional recordkeeping, disclosure, etc.)
- Since a common form of safe assets is government bonds, this is essentially the model of payments banks in India

Payment services

- Consistent regime for regulating all forms of payment service provisions
- Risks to users and overall financial stability concerns arising from payment services, such as intraday settlement risks and other systemic risks, should be addressed within the payment system framework, and should not differentiate by type of provider

Foundation of the Recommendations



The Challenge of KYC Rules

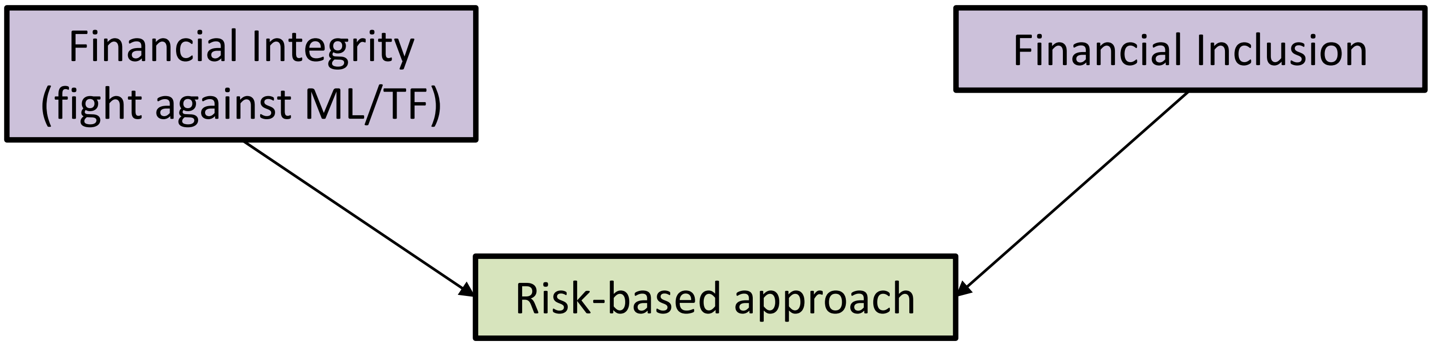
KYC rules can have positive and negative effects on financial inclusion:

- Providers that know their clients well may be more willing to extend their full range of financial services to them.
- Excessive KYC requirements can hinder financial inclusion as providers might find it too onerous to deal with the poor.

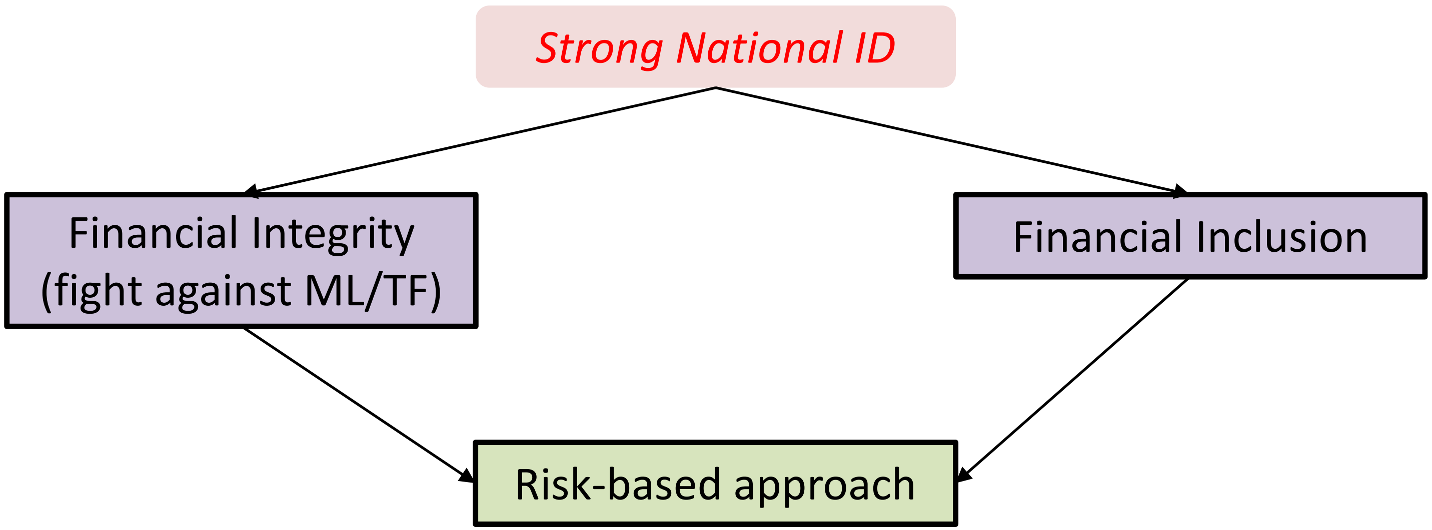
The Goal:

- Design KYC rules that are adequate to the task of maintaining financial integrity, yet do no create unnecessary barriers to financial inclusion, but rather work to enhance it. The risk-based approach is recognized as the way to go, but the challenge is the lack of clarity about how to implement the approach.

The Challenge of KYC Rules



KYC Rules: Examples of Recommendations



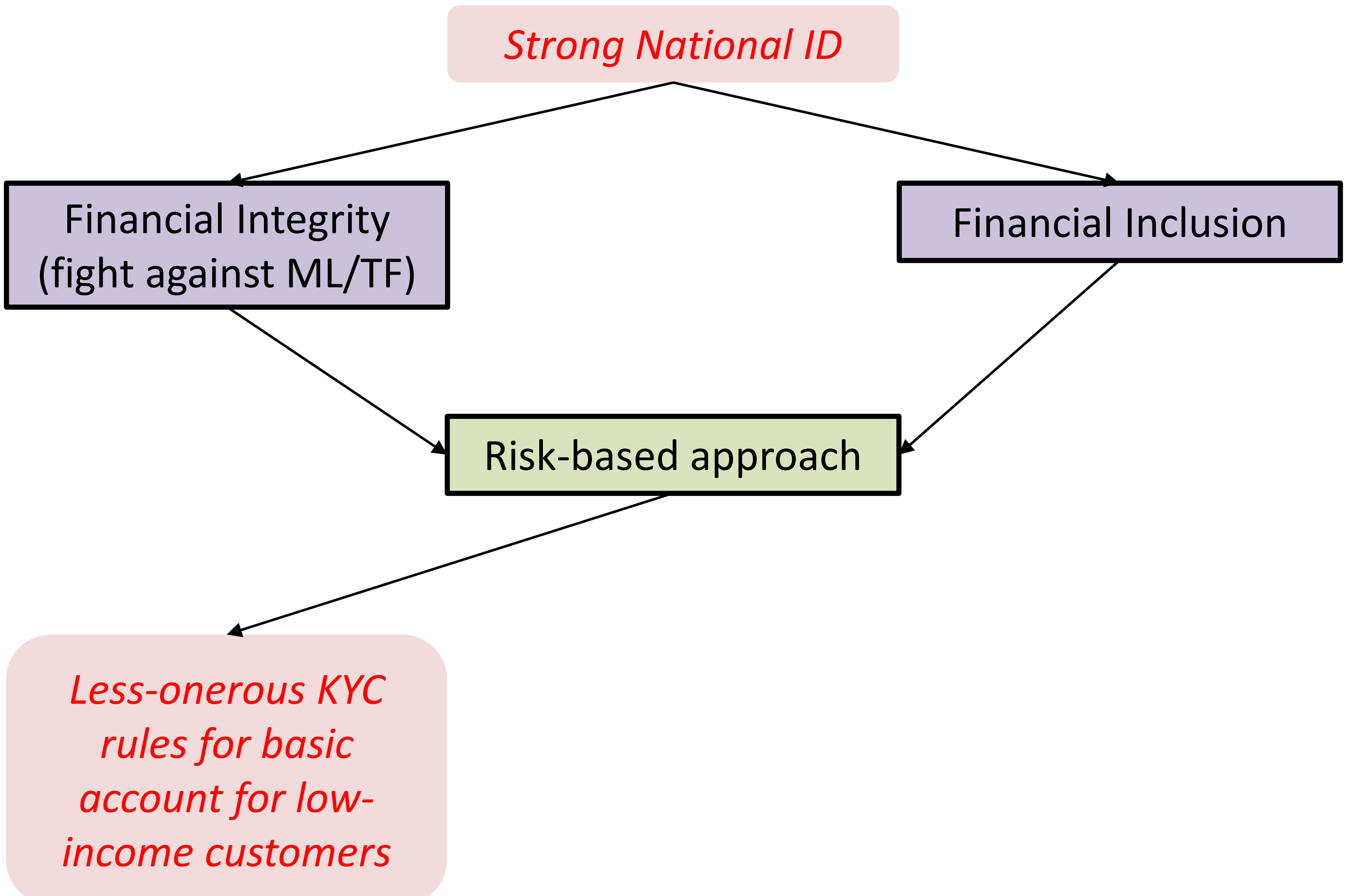
Know-Your-Customer (KYC) Rules: Country Experiences

<u>Rec:</u> National Identification systems must be strengthened, both to satisfy compliance with KYC rules for banks and DSPs and to promote financial inclusion

Technology-driven national identification system in India through Aadhaar

- Aadhar is a unique, secure identification number that can be verified online and in real time
- The 12-digit number is stored in a centralized database and linked to individual's biographic and biometric information: photograph, fingerprints, iris scans, and digital face prints
- By enabling people to open restricted accounts subject to later showing proof of Aadhaar, *India is using financial inclusion as a carrot that encourages registration rather than registration constraining financial inclusion*
- One billion Aadhaar numbers have been generated so far

KYC Rules: Examples of Recommendations



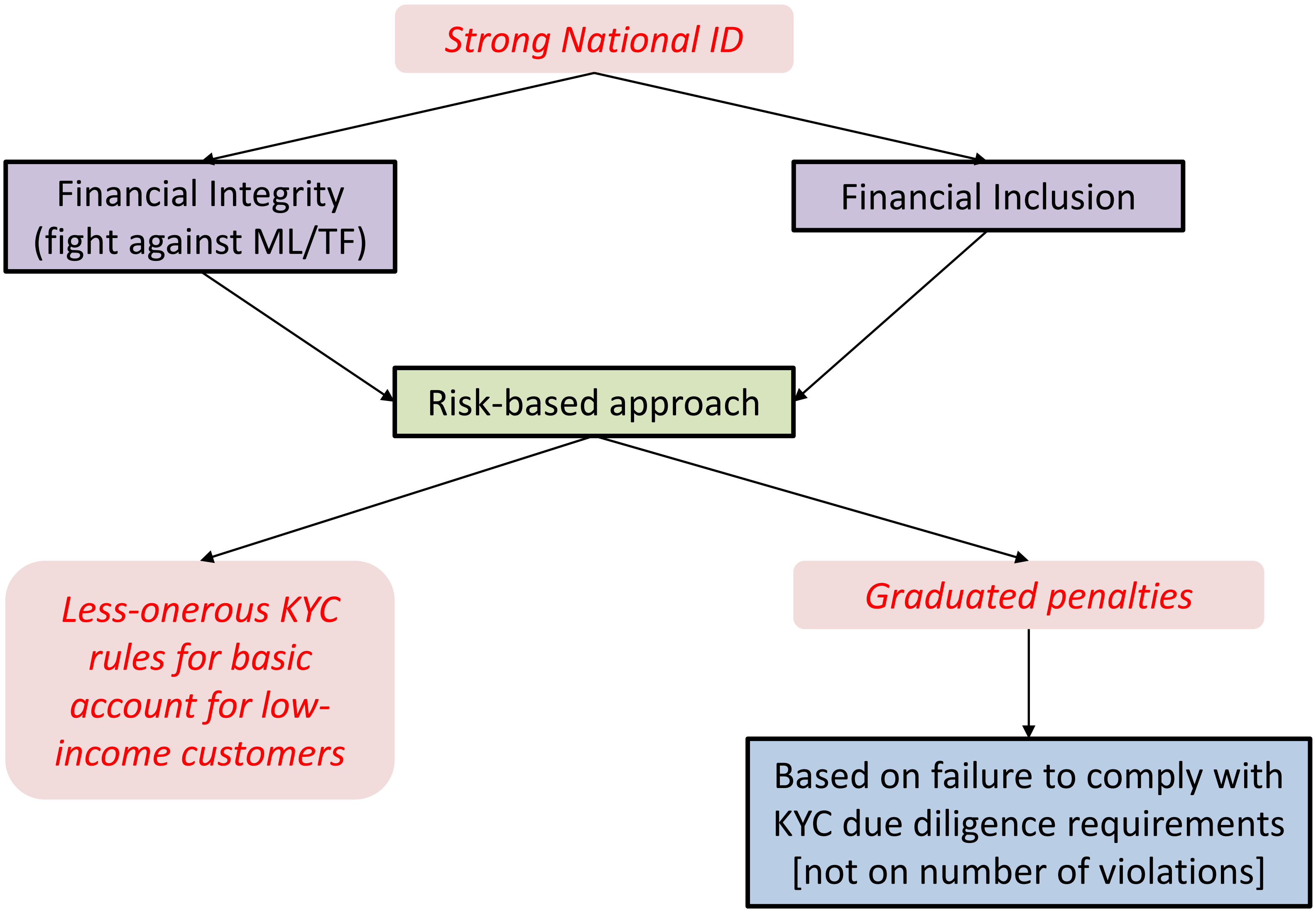
Know-Your-Customer (KYC) Rules: Country Experiences

Rec: Less onerous KYC measures should be required for certain types of basic accounts especially useful for low-income customers, with limits on their balances and size of transactions

Example: Reduced KYC requirements for "basic" bank accounts in India and Peru

	India		Peru	
	Basic	**Regular**	**Basic**	**Regular**
Requirements	• Photograph and finger print/signature • Proof of applying for Aadhaar within 1 year	• Proof of identity • Proof of residence • Accountholder's age	• National ID only	• Proof of identity • Proof of residence • Accountholder's occupation • Employer Information • Purpose of opening an account
Restrictions	• Maximum balance of US$733 • Monthly transactions may not exceed US$147 • Aggregate credit must not exceed US$1467		• Maximum balance of US$572 • Daily transactions capped at US$286	

KYC Rules: Examples of Recommendations



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