Regulating FinTech

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Agenda

- FinTech and Financial Inclusion
- The Bali FinTech Agenda
- Policy Actions around Regulating FinTech
- Resources
- Annex: Country Case Studies
1. FinTech and Financial Inclusion
What is FinTech

Advances in technology that can transform the provision of financial services by spurring the development of new business models, applications, processes, products, and services

Source: Bali Fintech Agenda paper

Source: World Economic Forum
New technologies and Fintech impact a wide range of financial services

Payment Services and Market Infrastructures
- Mobile Money; Acceptance devices, Crypto Currencies;
- Central Bank issued Digital currencies;

Distributed Ledger: Cross-border payments, FMIs, regional payments system, collateral registries

Deposits, Lending, Capital Raising, and Investment
- Online Banks, P2P lending, Market Place lending,
- Crowdfunding, Robo advisory

ID, Authentication, and Know Your Customer (KYC) utilities
- e-KYC, Digital signatures, KYC registries

Alternative data
- Social media, Call records, App downloads and usage,
- bill payments, payment behaviors

RegTech
- Ease compliance burden for banks, improve effectiveness and efficiency for regulators
- Shared KYC registries, APIs, Smart Contracts,
- Applications of AI

AI
- Cross-cutting theme with applications in RegTech, lending, investment, fraud detection, etc.
FinTech has enormous potential to expand financial access and inclusion

Potential for Fintech to:

- Reimagine financial processes and business models
- Enable new entrants and competition within the financial service value chain (disaggregation, specialization, open APIs)
- Enable services to be more accessible (incl. through mobile networks), often at lower cost
- Leverage electronic data to tailor product design, reach new consumers, accurately price risks [and to enable AI]

Potential Fintech-enabled Outcomes:

- Improved coverage of/ access to financial services
- Enhanced efficiencies and reduced costs, and also risk management
- New and more tailored types of products, services, and delivery channels
FinTech has enormous potential to expand financial access and inclusion

- **New, affordable products or services** that address the needs of the excluded and underserved customer segments (M-Pesa, BitPesa).

- **Distribution channels** that reach out to dispersed populations in remote and rural areas (AliPay).

- **Operational efficiencies** that allow financial services providers to serve low-margin clients profitably (Yu’e Bao).

- **Business models** that allow financial services providers to serve marginalized clients to achieve scale (PayGo).

- **Ways to address compliance** (e.g., customer due diligence) and risk management (e.g., credit scoring) barriers to financial inclusion (iProov).

- **Increased competition** that may prompt incumbents to focus more attention on unserved and underserved segments.
Leveraging the digital opportunity does not come without risks

- Potential risks to financial stability, integrity, consumer protection
- Trade-off between policy objectives: how to reach the appropriate balance?

**Financial inclusion**
(new, better and more affordable financial services)

- **Game-changer**: exponential technologies (mobile, internet connectivity, cloud)
- **Expand and enhance the offer**
- **Reduce the cost** of serving the bottom of the pyramid
- **Improve convenience**: collection and analysis of data for enhanced customization

**Challenges**
(ensuring control of potential risks)
Risks and Benefits

Although FinTech has the potential to rapidly expand financial access and inclusion, it also poses risks:

- **Depositor & investor risk:** New providers may be insufficiently regulated/monitored, and may not fully comply with disclosure or transparency requirements.
- **Regulatory & Supervisory Perimeter, Capacity:** FinTech players may not fit with regulatory/supervisory remits. Developing country supervisors have systems & capacity constraints.
- **Fraud or other market abuses, inc. AML/CFT:** Access to customer information can lead to abuse without adequate consumer protection mechanisms. Cryptocurrencies can be used for illicit activities.
- **Risks of cyber attack:** Cyber attacks can be at the regulator, financial market infrastructure, financial institution or consumer level.
- **Financial Stability:** Unsupervised linkages; Exacerbate credit cycles; Untested credit models; Affect banking system profitability.
- **Over-indebtedness:** New/easier access to digital credit may cause borrowers to be more susceptible, particularly without adequate financial capability.
2. The Bali FinTech Agenda
Background to Bali FinTech Agenda

- Rapid transformation of financial sector via advances in technology
- Given fintech’s global nature, country authorities’ requests to facilitate information sharing and cooperation
- Outline high-level considerations for policy makers and the international community – still at early stages of information gathering
- Engagement with Standard Setters
- IMF-World Bank interest reflects our universal membership, focused on respective areas of expertise and mandate
12 Elements, grouped into 4 Objectives

- Foster enabling environment to harness opportunities
- Promote international collaboration
- Strengthen financial sector policy framework
- Address potential risks and improve resilience
12 elements of The Bali Fintech Agenda

(I) Embrace the Fintech revolution

(II) Enable New Technologies to Enhance Financial Service Provision

(III) Reinforce Competition and Commitment to Open, Free, and Contestable Markets

(IV) Foster Fintech to Promote Financial Inclusion and Develop Financial Markets

(V) Monitor Developments Closely to Deepen Understanding of Evolving Financial Systems

(VI) Adapt Regulatory Framework and Supervisory Practices for Orderly Development and Stability of the Financial System

(VII) Modernize Legal Frameworks to Provide an Enabling Legal Landscape

(VIII) Safeguard Financial Integrity

(IX) Ensure the Stability of Monetary and Financial System

(X) Develop Robust Financial and Data Infrastructure to Sustain Fintech Benefits

(XI) Encourage International Cooperation and Coordination, and Information Sharing

(XII) Enhance Collective Surveillance and Assessment of Financial Sector Risks

Promote international collaboration

Foster enabling environment to harness opportunities

Address potential risks and improve resilience

Strengthen financial sector policy framework

Business continuity
Operational risk management
Privacy
Cyber security
Data ownership
Consumer protection
Data security and integrity
Concentration risk management

AML/CFT
RegTech
Fostering enabling environment to harness opportunities

(I) Embrace the Fintech revolution

Key issues: strengthen institutional capacity; improve communication with stakeholders and across agencies; and expand consumer education

(II) Enable New Technologies to Enhance Financial Service Provision

Key issues: facilitate development of and fair access to telecom and internet infra; financial infrastructure, digital IDs; digitize Government data repositories; and leverage technology to make cross-border payments efficient.
Fostering enabling environment to harness opportunities

(III) Reinforce Competition and Commitment to Open, Free, and Contestable Markets

Key issues: treat similar risks equally, apply laws and regulations proportionately; avoid market concentration and abuse; foster standardization and interoperability

(IV) Foster Fintech to Promote Financial Inclusion and Develop Financial Markets

Key issues: embed fintech in national financial inclusion and literacy strategies; foster knowledge exchange; digitize government payments; leverage fintech to advance financial sector development
Strengthen financial sector policy framework...

(V) Monitor Developments

Key issues: enable flexible data gathering frameworks to identify obstacles to innovation and new risks

(VI) Adapt Regulatory Framework and Supervisory Practices for Orderly Development and Stability of the Financial System

Key issues: ensure regulation remains adaptable and conducive to development, inclusion, and competition; consider new approaches like regulatory sandbox; address new risks and (cross-border) arbitrage

(VIII) Modernize Legal Frameworks to Provide an Enabling Legal Landscape

Key issues: legal predictability to spur investment; legal basis for smart contracts and electronic signatures; address legal gaps
Address potential risks and improve resilience...

(VII) Safeguard Financial Integrity

Key issues: mitigate AML/CFT risks that crypto-assets and other Fintech developments may pose, potential of Regtech to strengthen AML/CFT compliance

(IX) Ensure the Stability of Monetary and Financial systems

Key issues: Digital currencies, distributed ledger applications to payments, lender of Last Resort and other safety net arrangements

(X) Develop Robust Financial and Data Infrastructure to Sustain Fintech Benefits

Key issues: Cyber security and operational risk management, risk of concentration in third-party service providers, data governance frameworks

Business continuity
Operational risk management
Privacy
Cyber security

Data ownership
Consumer protection
Data security and integrity
Concentration risk management

AML/CFT
RegTech

AML/CFT
RegTech
Promote international collaboration

(XI) Encourage International Cooperation and Coordination, and Information Sharing

(XII) Enhance Collective Surveillance and Assessment of Financial Sector Risks

Key issues: to avoid regulatory arbitrage and a “race to the bottom”, to monitor global risks, to facilitate a global enabling regulatory and legal environment for fintech, and to stimulate sharing of opportunities

IMF and World Bank can provide capacity development in the areas of financial inclusion, consumer protection, statistics gaps, financial integrity, regulatory and legal frameworks, and cyber security
3. Policy Actions Around Regulating FinTech
Common Approaches to Regulating FinTech

- **Extensive**
  - ‘Case by Case Forbearance’ by regulators allowing new FinTech products and services going to market on a case by case basis, sometimes with extensive oversight.
  - ‘Structured Experimental Approach’ where FinTech products and services are tested through specified controls and are carefully observed.
  - Priority can be given to innovations relevant for financial inclusion.

- **Limited**
  - Incremental change of regulations as technology improves and is adopted by licensed entities.
  - ‘Single Window’ where FinTech products and services can go to market under a simplified framework.
  - ‘Hands Off’ where FinTech products and services go to market, regulators watch and intervene later.

Priority can be given to innovations relevant for financial inclusion.
Regulatory Tools

**WAIT & SEE**
- Allows innovations to develop with no restrictions
  - May work well in environments with limited regulatory capacity
  - Presents significant risk if not controlled later through regulations
  - Example: China

**TEST & LEARN**
- New innovations tested in a live environment with involvement from the regulators
  - Case-by-case basis
  - Requires active involvement by regulator
  - Difficult to scale up; hard to ensure equal treatment
  - Examples: Philippines, Tanzania

**REGULATOR Y SANDBOX**
- Virtual Environment where innovators can test their products/services in a time-bound manner
  - Greater transparency and replicability
  - Relevant for markets with good supervisory capacity and high level of active, potentially non-licensed players

**WAIVER/EXEMPTIONS**
- Waiver or exemption from a license or restrictive sections of a license
  - Usually codified in law, therefore no need for subjective decisions from the regulator
  - Legal certificate issued by the authority to indicate that it does not object the product or services provided by the fintech entity
  - Relevant for smaller markets, when the risk profile of the innovations are generally well-understood
  - Example: Kenya

**LETTERS OF NO-OBJECTION**
- Usually codified in law, therefore no need for subjective decisions from the regulator
- No special resources for maintenance are required
- Example: India: Payments Bank & Trade Receivables Platform license

**DIFFERENTIATED REGULATION**
- Enactment of regulations that support FinTech startups and consumer protection, competition, financial stability and financial inclusion
- Modifications to existing regulations
- Examples: EU (PSD2, GDPR), Mexico (FinTech Law)

**REGULATORY REFORM/LEGAL ENVIRONMENT**
Sample Actions for Regulating FinTech within an NFIS

Establish policy windows to prioritize the adjustment of legal / regulatory framework specifically for FinTech innovations that enhance Financial Inclusion

Assessments / Digital Strategies to encourage innovations or enable innovations for Financial Inclusion or to adjust the current legal framework (key examples include enabling eKYC, digital ID, alternative credit scoring, cross-border remittances, blockchain)

Explore establishing a structured experimental approach (like a Sandbox) or even accelerators / hubs specifically to encourage development of innovations for Financial Inclusion

Establish Committees / Working Groups to monitor FinTech for financial inclusion
But prior to selecting an approach or actions around FinTech for an NFIS, regulators and supervisors need to assess

- Regulators and supervisors need to conduct a deep, three-parts assessment pertaining to, at minimum, their institutional mandate and regulatory framework, supervision capacity and FinTech market

  The legal and regulatory framework and mandate

  Asking yourself about (i) your institutional and legal mandate to implement frameworks like a sandbox; (ii) how much flexibility already exists; (iii) what changes to the current frameworks might be required; and (iv) what implications on compliance.

Undertaking an honest review of your supervision capabilities. Are you in a position to carefully monitor and manage risks, for the financial sector and for consumers? Do you have enough technical knowledge?

Current supervision and oversight capacities

The current FinTech market

Taking a good look at your current FinTech market, which helps to clarify the need for a new approach to FinTech.
Policymakers today cannot afford to remain inactive with FinTech

- A few, *minimum actions* have been identified as becoming common practice
- These actions should implemented in general, and with regards to a window for Financial Inclusion

(i) **Regulator centric, internal market watch task force.** Regulators should institute an internal, regulator centric market watch with representatives from different departments (legal, IT, payment systems, financial stability) to assess and watch the emergence of FinTech innovations both domestically and internationally. Prior to selecting an approach to regulating FinTech, regulators and supervisors should increase their resources and build capacity to understand FinTech, new technologies, business models and their implications on the market and on regulation.

(ii) **Inter-regulatory agencies Committee.** A cross-institutional committee can be established and include relevant financial sector regulators and institutions for FinTech including (but not limited to) the central bank, the ministry of finance and other related ministries, the regulators for securities and insurance / pension (if other than the central bank), consumer protection agencies, the telecommunications regulator, etc. The committee can help foster and build capacity towards FinTech, understand the FinTech market from the perspective of other regulators and institutions, as well as enable a platform to help identify and understand an appropriate approach to FinTech.

(iii) **Sectoral-Stakeholder forum.** A sectoral stakeholder forum should include the majority of representatives from the cross-institutional committee, and also include financial sector providers (banks, non-bank financial institutions), FinTech companies, local and and other related market players and relevant stakeholders. The sectoral-stakeholder forum should aim to result in a knowledge exchange that increases the regulator’s sophistication in their understanding of FinTech innovations and business models and the provider’s appreciation of the policy objectives and expectations of the regulators.
4. Resources
Resources

• Regulatory Sandboxes and Financial Inclusion. CGAP.  

• G20 High-level Principles for Digital Financial Inclusion. GPFI.  

• The Bali FinTech Agenda. IMF.  

• Distributed Ledger Technology and Blockchain. WBG.  
Thank you!

Questions?
Annex: Case Studies
Example: Cross-border payments and eKYC

Today: SWIFT + Correspondent = Relay

Tomorrow 1.0: Bank-to-Bank in a peer-to-peer manner

Tomorrow 2.0: Party-to-Party = No banks involved at all?
Example: Cross-border payments an eKYC

Benefits of Digital ID

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<th>RELYING PARTY</th>
<th>INDIVIDUALS</th>
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<td>Easier Account Opening</td>
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<td>Better Authentication</td>
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<td>Identity theft and fraud prevention</td>
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<td>02P, 02B &amp; 02P Payments</td>
<td>Better credit scoring</td>
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<td>Streamlined Tax collection</td>
<td>O2P Payments</td>
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<td>Reducing of Gender Gap</td>
<td>Potential for interoperability</td>
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<td>More Efficient Social Programs</td>
<td>The ability to leverage value of legal IDs</td>
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<td>Reduction in cost and increased Efficiency</td>
<td>Reduction of Gender Gap</td>
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<td>Integration with Mobile Platforms</td>
<td>Access to credit, savings, insurance</td>
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<td>Improved document management and recording</td>
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<td>Role in Humanitarian Assistance</td>
<td>Improved customer service</td>
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<td>Single Customer View</td>
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Example: Digital ID - the case of Aadhaar

- **eKYC**: Aadhaar authentication sufficient for opening basic bank accounts and was central to the mass account opening campaign - PMJDY (Pradhan Mantri Jan Dhan Yojana). Over 250 million accounts opened in 2 years.

- **G2P**: De-duplication and targeting of Government subsidies and making Aadhar the “payment address” - enabling paying subsidies by mapping Aadhar number to bank account - Public Distribution System (ration), LPG Cylinders, Social Safety Net programs etc.

- **Aadhar based authentication of payment transactions and Digitally signing legal documents**: replacement of PIN for ATM transactions; Signing Tax Returns, Registering Title documents, registering lease-rentals etc.

- **Digital locker service**: Mobile based, intended to provide secure access to Government-issued documents and released based on approval of individual: 4.2 M users; 6 M uploads; 1.6 B issued documents