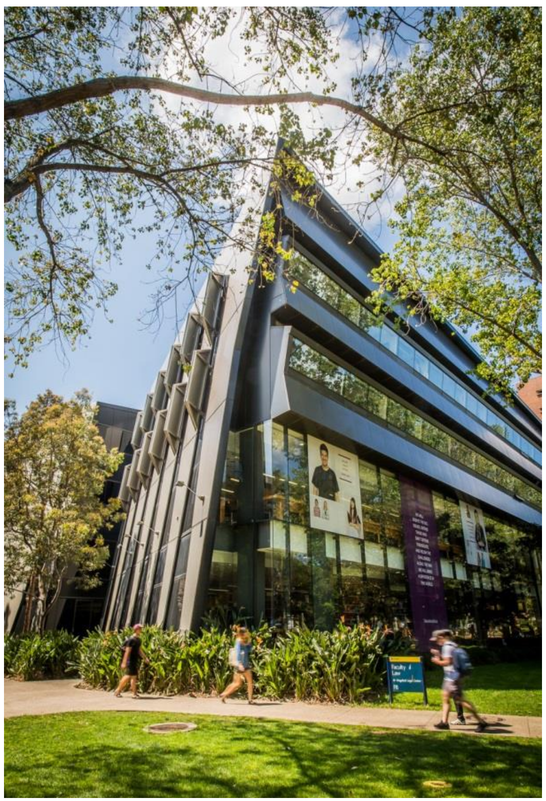
African Microfinance Week,
9 - 13 October 2017



Regulation of Digital Finance in the Global South - Challenges and Opportunities

October 10, 2017
5:00 – 6:00PM

Prof. Dr. Ross P Buckley

Scientia Professor, King & Wood Mallesons Chair of International Finance Law, UNSW Sydney

Moderator: Prof. Dr. Dirk Zetzsche

ADA Chair in Financial Law (inclusive finance)

Opportunities

- Title of this address is ‘Challenges and Opportunities”
- There is a reason e-money has thrived in poorer nations more than rich ones --- because the need for it is much greater there. We take so much for granted in developed countries.
- The opportunities are massive – accessing financial services in Timor Leste or the Solomons. “Leakage” of welfare payments in India. Loss of teacher salaries in Afghanistan. Simply paying an electricity bill without taking a day off work. Solving truancy among PNG teachers!
- India Stack!! The potential is massive.
- Lack of access to financial services is like a tax on an economy – it slows economic growth as it diverts human effort, and denies money often to those most in need.

DFS are mostly payments and payments are not banking

Yet traditionally banking, and payments, are both regulated by the central bank.

Both are vital. Capital needs to be well intermediated; and payments are the arteries of an economy, like pipes for water (and of course today more people have mobile phones than have access to clean water!)

But if payments systems break down, their being bailed out won’t break the national balance sheet. So scale of risks very different.

DFS are a hybrid product of payments coupled to stored value.

Risks

Payments systems seek to minimise risk

- Because more risk doesn't equal more profit (but less).
- Because more profits (and more convenience for customers) come from a larger network (strong network effects).

To minimise risk

- Providers mostly don't extend credit. The money used is the customer's.
- Providers seek to operate in as close to real time as possible.

  (These two characteristics of payments are VERY different to banking. See Ross P. Buckley and Ignacio Mas, "The Coming of Age of Digital Payments as a Field of Expertise," *Journal of Law*, *Technology & Policy,* Issue 1, pp 71-87, 2016, https://ssrn.com/abstract=1552754.)

Yet just because they share a regulator …

- Doesn't mean they need similarly strong levels of regulation.
- Banks like to load up on risk, because higher risk generally equates to higher returns and higher profits.
- Payments providers don't like risk, as higher risk generally leads to lower profits.

Yet central banks are a bit like surgeons …

- Doing nothing – maintaining a watching brief – paradoxically can be more challenging than passing regulations.

- Yet in our experience what is essential is:

  (i) consumer protection regulation,

  (ii) Float protection,

  (iii) AML/CTF regulation, and

  (iv) reporting requirements to the central bank so it can maintain an informed watching brief.

- The most important piece of the consumer protection puzzle is the recourse mechanisms – CBs need to proactively check that recourse mechanisms are free, manned, and work.

- And CBs need to be encouraging this strongly!

Why DFS are different to traditional banking

- Traditional banking regulation focuses on limiting the risks that banks take on.
- This doesn’t need to be the focus of payments regulation and doesn’t need to be the focus of DFS regulation because DFS don’t affect the money supply.
- Banks prosper from taking on risk and not much from network effects.
- Payments and DFS providers prosper from network effects but not from taking on risk.

So, in a perfect world …

- … because banking and DFS/payments are essentially different mindsets, the two industries would have separate regulators, even when the two services are both delivered by the one institution (a bank).

- Of course, we don't live in that world.

- One example of the problems of the same regulator has been the non-payment of interest on much e-money!

- CBs have been nervous about misleading customers as to the nature of e-money by allowing the payment of interest – thinking interest suggests it is a bank deposit –

- See L Malady, C-Y Tsang & RP Buckley, "Promoting Financial Inclusion by Encouraging the Payment of Interest on E-Money", forthcoming *UNSW Law Journal*, https://ssrn.com/abstract=3002925.

So, in our world …

- Once systemically significant, as they are today in Kenya and Tanzania, DFS require comprehensive regulation.

- However, in most emerging markets, DFS are not likely to become systemically significant any time soon.

- Innovation is dampened by over-regulation.

- The clear lesson of the trajectory of DFS in Kenya is that the central bank left the ecosystem alone for a relatively long time, and this helped it flourish.

- CBs need to set a clear policy direction that encourages interoperability. If interoperability isn't mandated at the beginning (to avoid restricting market development), providers need to know it is the ultimate destination and be encouraged to plan and design systems with this in mind.

The lesson for central banks

- The promotion of financial inclusion calls for an entirely new role for central banks – as promoters of innovation rather than limiters of risk taking.

- The newness and extent of this challenge for central banks is massive.

- It requires central banks to seek to understand consumer demand and for them to encourage providers to design DF products to meet it.

- There is also a case for resolution powers over Telco providers – and therefore for the DFS to be conducted in a subsidiary of the Telco –

- See K Kemp & RP Buckley, "Resolution Powers Over E-Money Providers", forthcoming *UNSW Law Journal*, https://ssrn.com/abstract=3002927.

In our world today …

- DF products are tech-driven, and often designed by tech-heads. This accounts in part for low take-up of many DFS. Strong need for experts in marketing and consumer issues – and strong need for these product designers to get out into villages, and conduct focus groups.

- Big telcos understandably want to roll out the same products in widely different markets – the Pacific is not one place, Africa is not one place.

Conclusion

- The most important pieces of the regulatory puzzle are: consumer protection, protection of the float, AML/CTF and a watching brief.

- Promotion of financial inclusion is a fundamentally new role for CBs. The scale of this change must be appreciated and is easy to underestimate.

- CBs need to encourage the offering of products suited to their market. This requires CBs and the providers to understand the local customer needs. This is a new role for CBs.

- CBs need to be data hungry and survey hungry. Grab every opportunity to learn more about the market. Encourage/require providers to link the CB into the data flow.

Thank you.

Our outputs are available at

http://www.clmr.unsw.edu.au/category/regulation-digital-financial-services

or just google: “UNSW DFS”

UNSW SYDNEY | Australia's Global University

UNSW SYDNEY