Standard Setting Bodies and Alliance for Financial Inclusion as Platforms for Peer Learning on Financial Inclusion

Discussion paper prepared by Dr. Tarisa Watanagase, former Governor of the Bank of Thailand, at the request of the Alliance for Financial Inclusion and the Intergovernmental Group of Twenty-Four, in preparation for the 5th Annual G24/AFI Policymakers' Roundtable.

Background

During their November 2010 Summit in Seoul, Republic of Korea, G20 Leaders called on "international relevant Standard Setting Bodies to consider how they can further contribute to encouraging financial inclusion, consistent with their mandates".[1] Since then, steps have been taken to convene relevant Standard Setting Bodies (SSBs), engage developing and emerging countries in a dialogue on global standards, and raise issues specific to the mandates of each SSB. As a result, the SSBs have launched initiatives to review the role of financial inclusion within their respective mandates. Most notably the Financial Action Task Force (FATF) has produced, and recently updated, a guidance paper to help developing countries craft new policies for advancing financial inclusion that are in line with its financial integrity mandate.[2] The Basel Committee for Banking Supervision (BCBS) has also issued guidance for the supervision of microfinance activities, and the Basel Consultative Group (BCG) of the BCBS launched a work stream on financial inclusion in February 2013.[3]

SSBs' Approach and Implications

Traditionally, SSBs focus their mandates on the formal financial sector for good reasons. The BCBS, for example, provides standards for common supervisory matters, particularly those pertaining to financial stability and the safety and soundness of individual institutions. These include standards for capital adequacy and cross-border supervision. While these are now widely applied, they were originally intended for large and internationally active banks because of their systemic significance to the financial sector. The capital adequacy rule, for instance, is to facilitate level playing fields among global banks and ensure safety and soundness. Given their sheer size, a poorly supervised global bank can have large systemic implications, extending beyond the home country via global inter-connectedness, as has been demonstrated during the recent global crisis.

On the other hand, the risks posed by different providers of, and products for, financial inclusion differ significantly from traditional and formal financial institutions. The capital of a credit cooperative is very different in nature from that of a bank since it changes with the

[1] G20 Financial Inclusion Action Plan (2010) (http://gpfi.org/our-work/work-plans/g20-financial-inclusion-action-plan)
[2] FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion (2011, Revised 2013)
http://www.fatfgafi.org/topics/financialinclusion/documents/revisedguidanceonamlcftandfinancialinclusion.html
[3] BCBS Guidance: Microfinance Activities and the Core Principles for Effective Banking Supervision (2010)
http://www.bis.org/publ/bcbs175.htm

number of members; hence, the BCBS requirement and definition of capital are not applicable. The fact that certain market segments or products are financially excluded implies that the market segment is probably too small or too costly to make a business case for traditional financial institutions. Therefore, the threat of systemic risk is likely to be negligible, although the number of customers affected may be large. This risk, together with the threat of an individual institution's failure, however, cannot be remedied with one-size-fits-all type standards because of the diverse nature of financial inclusion services and their providers both in and across countries.

For similar reasons, applying SSBs' standards for formal financial institutions with systemic implications to smaller providers of financial inclusion services, generally posing a much lesser threat to financial stability, can be counterproductive if the costs of complying are not adequately weighed against the benefits. Extending the mandate of the International Association of Deposit Insurers (IADI) to the realm of financial inclusion is another case in point. IADI's fundamental mission of financial stability is highly compatible with financial inclusion, where depositors are mostly small and un-sophisticated and deserve protection. However, the cost of increasing capacity for supervision of financial inclusion service providers, which is a precondition for deposit insurance, may be significant. Given limited resources and supervisory skills in some developing and emerging economies, it may be undesirable to divert supervisory resources and attention away from the traditional financial sector, which is generally bigger both in terms of size and importance to financial stability. Funding of the deposit insurance scheme for financial inclusion service providers and consumers is also a major issue which requires careful consideration based on country-specific costs and benefits.

The FATF, whose mandate is financial integrity, has rightly given attention to financial inclusion related risks, since admittedly smaller financial providers and transactions are not always risk-free as far as financial integrity is concerned. Nevertheless, extending FATF's AML/CFT requirements to financial inclusion can impose significant cost to the providers and regulatory hurdles to supervisors, depending on the circumstances and legal environments of the country.

Fortunately, most SSBs are aware that extending international standards to cover financial inclusion may lead to unintended consequences or even more financial exclusion because of the difficulty in complying and compliance costs. They have advocated a risk-based approach calling for countries to apply relevant standards proportional to the magnitude of risks. FATF has issued guidance for financial inclusion service providers to ensure financial integrity. The guidance is intended to provide comparative experience for different countries to consider and adopt under different contexts; in other words, a tailored rather than a one-size-fits-all approach. This seems to be the sensible way to proceed, although according to feedback from different countries, FATF has yet to coordinate with its standard assessors to ensure a common understanding and approach in their assessment of financial inclusion related risks, namely, that different countries' contexts must be taken into consideration.

BCBS also suggests that the Basel Core Principles (BCPs) for banking supervision generally offer a suitable framework for microfinance supervisors, who should apply the principle of proportionality or a risk-based approach in supervision and in allocating scarce supervisory resources. In fact, BCBS is adopting the same principle of allocating its resources to where the risks are highest such as the big global banks and SIFIs (systemically important financial institutions).

Proposed new role for SSBs

Financial inclusion practices and related issues are vastly diverse depending on each country's unique economic, financial, technological, geographical and legal environments, among other things. As such, the continued calls by some authorities and international bodies for SSBs to issue further guidance and clarification could be counterproductive and is a source for concern.

In order for SSBs to effectively contribute to encouraging financial inclusion, as consistent with their mandates called for by G20, a useful and constructive approach is for SSBs to provide peer learning platforms for authorities. Such platforms enable authorities to learn from each other's diverse experiences in promoting financial inclusion while at the same time preventing or mitigating the threat to financial stability and integrity. SSBs are well-placed for such a role given their access to information gathered through dialogues and surveys with members. Of course, since developing and emerging countries have significantly different experiences in financial inclusion issues than developed countries, they must have sufficient representation and their opinions adequately reflected in SSBs' work to make the pools of information relevant. Recently, the BCG launched a work stream with a plan to conduct a range of practice surveys in 2013 on inclusive finance as an update of the 2008/09 survey conducted with Committee members on microfinance activities of banks and other deposit-taking institutions. This will be an excellent opportunity to disclose survey information for peer learning rather than using it to formulate a new set of guidance.

The Role of AFI

Providing peer learning for the promotion of financial inclusion has been an important mission of AFI and will remain so even with the proposed new role for SSBs to provide peer learning platforms. Even with the proposed expanded participation from developing and emerging countries in SSBs, there will still be many non-members of SSBs. This is where AFI can play an important role. With the bulk of its members consisting of developing and emerging countries, many of which are not members of SSBs, AFI can be a collective voice in information sharing with SSBs. Through its direct engagements with members, AFI can also provide peer learning on issues that may not be within the direct mandate of SSBs, such as consumer protection. It can voice its concerns, as well as those of its members, to SSBs. A case in point is the seemingly increasing need for the Committee on Payment and Settlement Systems (CPSS) and BCBS to work closely on new payment providers and products, as well as those related to financial inclusion. While CPSS's focus is on financial infrastructure, including costs, efficiency and security, especially of innovative products, BCBS focuses more on the providers, including their licensing requirements and supervision. In fact, such evolving needs have led to re-organization or re-alignment of works in some countries in their oversight of payment systems and bank and non-bank financial institutions, an issue that members will also merit from peer learning.

Suggested Topics for Discussion:

- Is facilitating peer learning a more effective way for SSBs to promote financial inclusion that is more consistent with their mandates than the approach of issuing guidance on their respective mandates?
- If G24 & AFI members agree on the proposed new role for SSBs, what are the most effective ways to take this dialogue forward with the SSBs?
- How can developing and emerging countries build up their own perspectives to be shared and discussed with relevant SSBs?
- How can AFI as a network of developing and emerging country regulators and policymakers facilitate such a venture to add meaningful value to the present dialogue with the relevant SSBs and support its members in their effective interaction and engagement with SBBs?
- Are there specific issues on which G24 and AFI members want AFI to work with the SSBs?