Plenary 2: Policy and Regulation attuned to the Pacific

Session Synopsis
The use of digital financial services is growing globally. This trend is also evident in the Pacific, however, there are several challenges that need to be addressed in order to realize the full potential of digital finance as a key component of financial inclusion. A pragmatic regulatory framework for digital finance in the Pacific for both banks and non-banks needs to stimulate innovation and access, while at the same time ensuring that critical issues such as consumer protection and interoperability are aligned with broader financial inclusion strategies.

**Session Moderator:**
- Mr. Gane Simbe, Deputy Governor, Central Bank of Solomon Islands

**Speakers:**
- Mr. Ross Buckley, CIFR King & Wood Mallesons Professor of International Finance Law, UNSW & ADB-PSDI consultant on digital financial services
- Mr. Abraão de Vasconselos, Governor, Banco Central de Timor-Leste
- Mr. Noel Vari, Director of Financial Institutions Supervision, Reserve Bank of Vanuatu
- Mr. Vereimi Levula, Chief Manager, Financial System Development, Reserve Bank of Fiji

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**Getting the Framework Right**

Banks and payment providers operate in very different ways. For banks, risk can be viewed positively as it provides opportunities to make profits. On the other hand, payment providers are adverse to risk and attempt to minimise it by operating as close to real time as possible, and on a fully funded basis. Traditional banking involves managing risk and building relationships with customers, while payment providers utilize networks, with the greater numbers of users on the network enabling the provision of more valuable the services. Although banking and payment services have very different appetites for risk, they are regulated by a single institution. This is problematic because traditional bank regulation is not always applicable in the payment space.

Regulation is time consuming and expensive, so unless there is systemic risk there is no need for haste with heavy regulation. One issue which is hampering the success of digital financial services in the Pacific is the lack of consumer demand. Central banks can play a role in gathering data and bringing stakeholders together to explore options to stimulate consumer demand and use.

According to CGAP, there are five key elements that a regulatory framework for digital financial services should address:

- The regulation of banks or MNOs in using agents;
- Flexible, risk-based anti-money laundering and counter terrorism financing regime;
- Clear regime for non-banks issuing electronically stored value;
- Consumer protection tailored to digital financial services; and
- Payments system regulation that in the long-term at least allows broad interoperability and interconnection.

Furthermore, regulators should also consider enhanced transaction monitoring in order to simplify know-your-customer procedures.

A regulatory framework needs to provide consumer protection, while still leaving room for digital financial services to develop, as well as flexibility for cross regulation between the different agencies responsible for supervision of banks and telecommunications companies.

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### The Importance of Government Leadership

The financial industry globally is currently undergoing significant changes with digital financial services becoming more mainstream. Central banks have a role in overseeing these changes and their focus should be on ensuring that these services are adequately and appropriately meeting the needs of customers. Since many of these digital products and services have been developed by technology experts who often lack marketing skills this has led to many products and services being designed that do not adequately meet consumer demand. Ideally, innovation should be consumer driven rather than technology driven.

To promote financial inclusion, government-to-person payments are important for cultural change. People need a reason to make the change to using digital products and services, and receiving money from the government through digital channels can drive this change. Once they begin using digital finance platforms it is significantly easier for them to then try and use other digital products and services.
While the central bank can take a lead role, partnerships with financial services providers (banks, mobile network operators, microfinance institutions, insurance companies, money transfer operators, etc.), are essential in areas such as agent networks, consumer protection, and financial education. Government agencies (such as education departments and commerce commissions) and consumer councils are also essential partners in an effective financial inclusion ecosystem.

**Proportionality in Regulation**

An important feature of proportionality is that there should be different regulatory regimes for different sized financial institutions, as too onerous regulations may hinder the success of smaller agencies that are advancing financial inclusion.

There is an argument that bigger institutions carry a bigger risk for the overall financial system, and should be regulated more heavily. In terms of capital adequacy, there is no level playing field, so it makes sense to use proportionality as a guiding principle in the policy space.

**Key Points:**

- Regulators need to understand the different needs and operating methods of traditional banks and payment providers. In most cases in the Pacific, both types of institution are regulated by the same institution and given the same rules. Governments should instead consider appointing different entities to regulate both types of financial services providers in order to provide regulation which is more relevant, applicable and meeting the needs of both the institution and their customers.

- With the growing popularity of digital financial services, central banks can play a lead role to ensure that the needs of customers are being met. Furthermore, central banks can play an important part by gathering data and facilitating dialogue between stakeholders to further drive consumer demand.

- A one-size-fits-all method of regulating financial institutions may not be the most effective or efficient way to achieve the desired result. Instead, consideration should be given to how regulation impacts institutions of different sizes and apply proportionate regulation. Proportionate regulation will create a fairer playing field as well as support the growth and stability of smaller institutions.
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