



# **ITU Workshop on “Digital Financial Services and Financial Inclusion”**

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## **Current & Future Trends In the Legal & Regulatory Aspects of DFS**

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# DFS Regulatory Overview

- We are at 'DFS 1.0'
  - Basic DFS FI services like P2P, CI, CO
  - Laws & Regulations still evolving
  - Requires new skill sets & understandings
  - Often an absence of enabling laws & regulations such as a National Payment System Acts
  - Issues of investor certainty, level playing fields, customer comfort & access, financial integrity
  - Catalyse DFS
  
- Arriving Soon is 'DFS 2.0'
  - Disruptive services and technologies
  - Will challenge regulators ability to keep up, and make good law

# Primer:

## *Types of Regulatory Approaches*

### ■ **Functional**

- Focus on the activity regardless of the type of institution providing that service.
- **Pro:** May allow innovation to flourish, with new entrants
- **Con:** May lack capacity to pronounce on complicated issues

### ■ **Institutional**

- Focuses on institutions providing the activity
- **Pro:** Leaves the regulation in the hands of specialised bodies.
- **Con:** May distort market dynamics by fragmenting responsibilities amongst too many regulators - some entities may not be captured

### ■ **Specific**

- Dedicated agency and regs
- **Pro:** regulate specific entities and services
- **Cons:** innovation may outrun the dedicated agency

# Primer:

## *Current Regulatory Challenges*

### ■ **Coordination**

- Decide which state bodies have jurisdiction via MOUs
- No coordination may create conflicts

### ■ **Arbitrage**

- Conflicting regulations and laws
- Firms can capitalise on loopholes to circumvent unfavorable regulation

### ■ **Failure**

- Incorrect, incomplete or regulations and laws

### ■ **Over-reach**

- Unnecessary laws & regulations

### ■ **Capture**

- Where a sector has inordinate influence over a regulator, to possible public-policy detriment of others

# "The Regulator's Dilemma"

- How to balance innovation & financial inclusion versus (systemic) risks
- Financial Inclusion versus Financial Integrity
- Extreme price-sensitivity in the BOP segment
- Each country may have unique challenges

# Solving The Dilemma: Best Practices

- Use:
  - Proportional Regulation
  - Risk Based Approach to AML to enable access
  - Test 'n Learn Approach vs Mandate and Monitor
  - Oversight
  - Engagement with private sector
  - Market-led approach
  - Incentives to promote innovation
  
- Ensure no conflicts with common law views on banking/payments etc



Lets look at current regulatory  
implementations with DFS 1.0

then

New challenges in regulation  
with DFS 2.0

# DFS 1.0: Primary Regulators

- Central Bank
- Ministry of Finance
- Ministry of Telecommunications
- Telecommunications Regulator
- Financial Intelligence Unit



# DFS 1.0: Type Of Laws & Regs

- **Banking Laws**
  - ◆ Trust accounts for safety & soundness
- **Payments Laws**
  - ◆ e-money-type laws & regulations
  - ◆ Licensing/NOL
- **AML/KYC Laws**
  - ◆ Tiered accounts
- **Telecommunications Laws**
  - ◆ Content Licenses for DFSPs
- **E-commerce Laws**
  - ◆ Basic Consumer Protection Framework
- **Common Law**
  - ◆ eg Contract & evidence where no enabling or applicable laws

# DFS 1.0: Regulatory Trends

- NOL in absence of enabling frameworks
  - ➔ eg When no NPSA
- Bank Led vs Relatively Open
  - ➔ Trending to open
- Safety & Soundness Rules
  - ➔ Ringfence accounts in Trust Accounts
  - ➔ Capital Requirements & Auditing
- Agent rules
  - ➔ Exclusivity and operation

# DFS 1.0: Regulatory Trends

- Usage/Access Fees capped or regulated
- Taxes
- No intermediation allowed
- Strict, non-RBA Bipolar AML policies
  - P2P & Corporate vs missing SMMEs
  - "Missing Middle"



# **Country Case Studies**

# Kenya

- National Payment Systems Regulations 2014
  - Formal legal framework for MFS, replacing NOL
  - CBK's oversight, inspection and enforcement duties are formally recognised.
  - Functional approach
  - Banks and non-banks can do DFS
  - Customer funds must be held in trust
  - Service providers can appoint agents and are responsible for the actions of agents
- Licencees must apply BIS and FATF principles
- Interoperability
  - Recognises PSPMB for clearing & settlement

# Colombia

- Oct 2014
  - New Financial Inclusion Law
- URF
  - Specific authority for enhancing FI
- "Companies Specialized in Electronic Deposits and Payments" licenses
  - For non-banks & banks
  - "Bank-led model was not completely successful in increasing transactions"
  - Can do remote cash-in & cash-out operations; remittances, transfers, and payments; use agents
  - No intermediation allowed
  - Requires US\$3m for incorporation
  - Pass through insurance to US\$10,000

# India

- Primarily bank-led DFS model
- Regulations Nov 2014
  - MNOs cannot implement DFS into their established retail networks
  - Dedicated DFS retail channels required.
- Open Issues of taxation
  - Revenue from DFS part of annual gross revenue?
  - Ruling via RBI, DOF, DOT

# DFS 2.0: Regulatory Issues

- More open licensing
- Interoperability
- Provision of Credit
- Big Data Use & Security
- Competition & fair access to technology
- International & regional remittances



# DFS 2.0: Disruption & Regulation

- MVNOs by banks & others
  - ◆ Thin SIM
  - ◆ Blank SIM
  - ◆ SoftSIM
  
- Crypto-economy
  - ◆ Disintermediation of regulated entities
  - ◆ Crypto currencies eg Bitcoin & other Altcoins = money etc?
  - ◆ P2P transfers
  - ◆ Asset distribution
  - ◆ IPOs
  - ◆ Digital IDs
  - ◆ Smart Contracts

# DFS 2.0: Disruptive Smartphones

- Infusion of cheap Android-based smartphones
- Apps replace menus
  - More functionality versus feature/basic phones
- Data use replacing USSD/SMS for DFS access may raise issues of Net Neutrality
  - Some apps may get preferential data speeds and rates
- InApp Purchases raise consumer protection issues
- Transport
  - eg Uber/Lyft/Hailo live car reservation services
- Accomodation
  - AirBnB for private homes as hotels
- Data privacy & security
  - NFC

# DFS 2.0: New Regulators Involved

- **DFS entities in v1.0, plus...**
- **Competition Authorities**
  - Interoperability availability
  - Pricing
  - MNVOs
- **Transport Authorities**
- **Tourism Authorities**
- **Agriculture**
  - Payment of subsidies & crop insurance

# DFS 2.0: New Regulators

## ■ Home Affairs Departments

- Digital IDs

## ■ Financial Services Authorities

- Credit Provision
- Crypto IPOs & Asset classes

## ■ Justice & Industry Ministries

- Crypto Smart Contracts

## ■ Securities Bodies

- Crypto as intangible assets vs money

## ■ Taxation

- Bitcoin trading profits = capital gains?

# Summary & Recommendations

- Regulation should be proportional to the extent of a particular risk.
- Avoid mandating specific technology & transaction solutions
- Form Working Groups to coordinate with other state entities to prevent regulatory arbitrage
  - Have effective MoUs in place
- Grow market without penalising early innovators
- Disruption is coming:
  - Omni-channel effects
  - Will test existing policies, skill sets, laws & regs
  - Coordinate Coordinate Coordinate