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INCLUSIVE FINANCE FOR EXCLUDED PEOPLE
MICROFINANCE REFOCUSING ON THE UNDERSERVED, UNSERVED AND VULNERABLE

Non-Prudential Regulations
Key Issues and Global Standards

CGAP

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Financial Inclusion requires adapted prudential and non-prudential regulation

Prudential' regulation aims . . .

. . . to protect the ***financial solvency*** of the regulated institution

- to protect depositors from the loss of their savings and
- to protect the financial system from the so-called contagion effect when one depository institution fails

Non-prudential regulation involves . . .

. . . regulatory objectives that can be achieved ***regardless of financial health*** of regulated institution, e.g.

- permission to lend
- transparency regulations
- tax treatments
- consumer protection regulation (other than depositor protection)
- regulation on financial crimes (e.g., AML/CFT)

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Who regulates & supervises microfinance?

Different regulatory bodies ***oversee*** the various areas of regulation:

- ***Prudential regulation*** and ***supervision*** involves ***banking and insurance supervision authorities***, as well as specialized supervisory bodies in some countries ➔ High costs

- ***Non-prudential regulation*** covers a variety of topics and therefore ***involves a variety of regulators***, depending on the country and type of service provider, such as:
  - Consumer protection agency
  - Financial Intelligence Unit
  - Ministry of Finance

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Example of Non-prudential regulation – AML/CFT

Anti-money laundering (***'AML'***) regulation – aimed at stopping ***money laundering***:

- process to disguise the illegal origin of criminal proceeds without jeopardizing the source of the funds

Combating financing of terrorism (***'CFT'***) regulation – aimed at stopping ***terrorist financing***:

- fundraising for or financing of organizations or persons involved in terrorism

Some ***BIG AML/CFT*** issues for inclusive finance:

- Know your customer/customer due diligence' (***KYC/CDD***) for the 'unidentifiable' poor
- ***Record keeping*** and suspicious transaction reporting
- '***special attention '*** to threats that arise from new or ***developing technologies*** which ***favour anonymity; non-face to face relationships and transactions***

For more details: Upcoming Microfinance Consensus Guidelines: A Guide to Regulation and Supervision of Microfinance provides detailed information on prudential and non-prudential regulation for microfinance

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Standard Setting Bodies can contribute to improved regulatory frameworks for financial inclusion:

- One component of G20 GPFI is to embed FI in SSB's work:
- Relevant standard-setting bodies (***SSBs***):
  - Basel Com on Banking Supervision (***BCBS***) : *first-ever Basel Committee publication on a financial inclusion topic*
  - Com on Pay't & Settlement Systems (***CPSS***) : *launching of working group on innovative retail payments*
  - Financial Action Task Force (***FATF***) : *first SSB guidance paper recognizing financial exclusion as significant risk*
  - Int'l Ass'n of Deposit Insurers (***IADI***) : *formation of Sub-committee on Financial Inclusion and Innovation*
  - Int'l Ass'n of Insurance Supervisors (***IAIS***) : *draft guidance paper on inclusive insurance markets (based on previously issued microinsurance issues papers)*

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Key messages from White Paper: Financial exclusion carries risks within SSBs' sphere of interest

includes:

Threats to financial integrity and international security

(e.g. money-laundering and terrorist financing risks of cash transactions, often across borders, through informal providers)

Social and political stability, and even potentially financial stability

(e.g. political unrest touched off by pyramid schemes organized as informal savings and investment opportunities that trigger lack of confidence in the banking system)

subject has not yet been systematically studied for any SSB

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Key messages from White Paper: Changing risks and benefits accompany increased financial inclusion

These risks and benefits result from a variety of factors, including:

- Characteristics of financially excluded customers (which differ from "already served" with which SSBs are most familiar)
- Nature of the products, services, and providers capable of reaching them, and
- Especially innovative approaches needed to accomplish significant increases in financial inclusion (e.g. mobile phone banking)

Benefits of financial inclusion, such as economic growth, efficiency, and increased welfare offset these changing risks and also mitigate risks of financial exclusion

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Key messages from White Paper: Country context matters

- Current nature and level of financial exclusion in the country
- Capacity of policy makers, regulators, and supervisors to implement SSB standards and guidance

SSBs' normative standards relevant to increasing financial inclusion may be designed to be applied flexibly in all country contexts…

… but guidance may be needed for countries with particularly high levels of financial exclusion and low levels of capacity of supervisors and institutions

=> Importance of **proportionality**