Regulating for innovation

How to encourage responsible market innovation?

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Regulation and innovation often seem to be conflicting objectives.

- Regulators are usually mandated to mitigate risk, not support innovation.
- There is a need for FSPs to innovate in an environment that allows regulators to contain the potential risk, while having an opportunity to test regulation.

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DFS innovation as a double-edged sword

- Upside
  - Potential for higher level of inclusion both in access and number of products
  - More viable and consumer-centric approaches
  - Fewer adoption barriers and hassle factors
- Downside
  - Disruption of established processes and services
  - Displacement of the formal with the less formal and informal
  - Changes in known risks
  - New known unknowns and unknown unknowns

Typologies of DFS innovation

Instruments

- Vouchers
- Airtime
- Cash equivalents
- Cryptocurrency
- DFC (eFiat)

Protocols and Standards

- ISO 20022
- USSD
- Thin SIM
- API
- DFC (eFiat)
- Distributed Ledger
- ILP

Intermediaries and Hubs

- Mobile Money Agency
- Peer Agency Models
- Cross-Border Hubs
- Distributed Ledger Operators and Correspondents

Identity

- Digital Touch Points, IoT
- GPS and mobile
- Social Media
- Biometrics
  - Iris, Sclera
  - Facial
  - Fingers
- Financial Identity

… and with these innovations come many advantages, but also new risks to be mitigated

Instruments

- Is transaction intermediated?
- Jurisdiction and mandate?
- Identification of principal actors?
- Identification and ML/FT assessment of counter-parties?

Protocols and Standards

- Enhanced technical capabilities enabling reliable identification and verification of all parties and intermediaries

Intermediaries and Hubs

- Enhanced technical capabilities enabling identification
- Real-time processing stresses ML/FT monitoring
- OTC risk of cash

Identity

- Legal frameworks absent
- Enhanced CDD potential
- Access to identification data
- Consumer privacy rights

“Supporting innovation is an opportunity for regulators and market catalysts to encourage market development, but with it comes **new consumer protection and systemic risks**.”

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“The concept of a **regulatory sandbox** is developed as a regulatory approach to **creating a safe space** to help regulators to tread this delicate balance. Enabling innovative ventures but **limiting the size and scope of the risk** to enter the market.”

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What is a sandbox?

- **Sandboxes:**
  - Explicit and transparent entry criteria for applicants
  - Each sandbox venture assessed individually with tailored safeguards implemented
- **Test and Learn applies the same underlying principle.**
  - Sandboxes tend to be more explicit, transparent and accessible to all potential applicants. Most test-and-learn models rely on the provider approaching the regulator unprompted.

"The principle of a sandbox can take many different forms. In practice, no two sandboxes are the same."

When implementing a sandbox, what tools are available to regulators?

- Regardless of exact form or what it is called, broadly, two categories of implementation tools exist:
  - Explicitly reduce regulatory barriers for innovators with **temporary bespoke regulatory treatment**
  - Implicitly reduce regulatory barriers with **communication and support tools**

Unpacking the sandbox implementation tools:

Temporary bespoke regulatory treatment

- **Temporary bespoke regulatory tools:**
  - Restricted authorisation/reduced licensing requirements
  - Waivers or exemptions
  - No enforcement action letter/letter of no objection
  - Active engagement with providers, other regulatory authorities, flexibility
  - Appropriate safeguards
- **Examples:**
  - BNM Malaysia, CMA Kenya, IPEC Zimbabwe, UCC Uganda, FCA UK, NIC Ghana, TIRA Tanzania

Unpacking the sandbox implementation tools:

Communication/support

- **Communication/support tools:**
  - Advice unit
  - Innovation hub
  - Innovation accelerator, industry/data sandbox
  - Incubators
  - Innovation workshops
- **Examples:**
  - Australia, France, Hong Kong, Japan, Korea and UK

When is a sandbox appropriate, and what are the critical design considerations?

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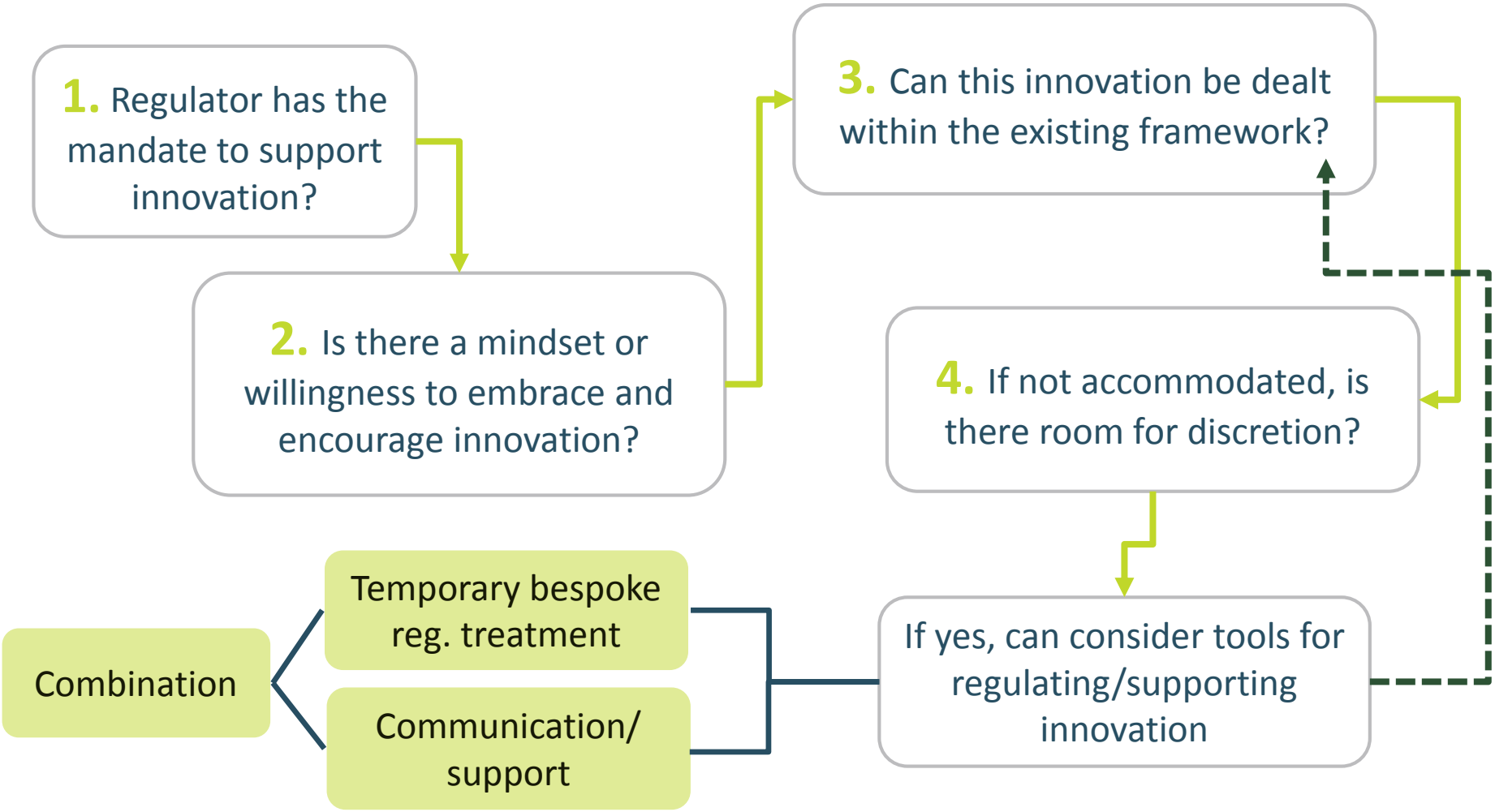
Navigating the "decision path"



(Or "turning a blind eye")

Critical considerations in applying innovation support tools

Coordination

- Innovations often cut across authorities
- Options to address
  - MOUs
  - Inter-governmental committees
  - Be limited to products that fall within single regulator's mandate

Capacity

- Required for monitoring, advice, understanding risks
- Determines which tools can be implemented and how extensively
- To address:
  - Recruit and train for skills appropriate to the changing nature of the sector.

Regulatory barriers faced by providers in the market

- The tools implemented need to address the actual challenges faced by innovators in the market.
- To address:
  - Consultation with market players to understand primary challenges faced

"The principle of creating a safe space to test and, most importantly, learn from new innovation is appropriate for developing-country financial regulators to consider.

However, the nature and design of this approach will differ depending on context and market realities."

- Whether to implement a sandbox or what is and is not a sandbox

- Going through the decision path in a deliberate way, being clear about the objectives, considerations and reality checks
- View approach to innovation in light of overall approach to market development

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Thank you

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About Cenfri

The Centre for Financial Regulation & Inclusion (Cenfri) is a global think tank and non-profit enterprise that bridges the gap between insights and impact in the financial sector. Cenfri's people are driven by a vision of a world where all people live their financial lives optimally to enhance welfare and grow the economy. Its core focus is on generating insights that can inform policymakers, market players and donors seeking to unlock development outcomes through inclusive financial services and the financial sector more broadly.

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FSD Africa is a non-profit company that aims to increase prosperity, create jobs and reduce poverty by bringing about a transformation in financial markets in Sub-Saharan Africa (SSA) and in the economies they serve. It provides know-how and capital to champions of change whose ideas, influence and actions will make finance more useful to African businesses and households. It is funded by the UK Aid from the UK Government. FSD Africa also provides technical and operational support to a family of 10 financial market development agencies or "FSDs" across SSA called the FSD Network.

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