



Financial sector regulation in the digital economy:

*Priorities for
emerging
markets*

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Introduction

The global financial sector has undergone rapid changes in recent years and regulators are faced with the dual challenges of regulating a financial sector that is continually innovating, and ensuring the regulators themselves are leveraging technology to enhance their performance. Much has been said about the opportunities created by technology, yet in emerging markets, there remain significant gaps in regulatory capacity and approach that are exacerbated by the changes brought by technology. Dealing with the disruptions of technology can be particularly daunting for emerging market regulators.

In this context, and having worked closely with central banks in emerging markets over the past years, we've identified five regulatory and policy priorities that are important for financial sector regulators, particularly in emerging markets, to deliver on their mandates to safeguard and support the financial sector as an enabler of greater economic inclusion and development.



Recommendation 1

Prioritising innovation and harnessing technology

Regulators are moving and adapting, but the market is moving faster.

Financial service providers (FSPs) are rapidly leveraging technology to gain a competitive edge, reduce costs and enhance compliance. Regulators and supervisors are struggling to keep up as they face challenges with bureaucratic processes, capacity gaps, legacy systems and limited access to specialised skills.

This constrains regulators' ability to effectively oversee increasingly complex and digitised financial systems. To have any chance of keeping up with the market, we recommend regulators prioritise two complementary actions:

- **Integrating technology into supervision.** This should be driven by a clear technology strategy that addresses all aspects of tech-enabled or supported supervision with both short- and long-term considerations for the regulators' needs and opportunities. It should prioritise high-impact use cases, for example, those that reduce reliance on manual processes, improve risk detection, enhance supervisory capacity or reduce reporting burdens for FSPs. It should promote a testing-and learning approach to tools and techniques, including those powered by AI, to improve data collection, analytics and risk detection. As an example, the Bank of Namibia has already deployed an AI-driven model for monitoring non-performing loans and enabling supervisors to more effectively detect, forecast and manage credit risk. It also has developed a comprehensive strategy for the broader use of AI across the organisation.
- **Top-down, senior leadership support for innovation to drive cultural shifts within regulators.** To effectively implement a supervision strategy that has technology and innovation both as its foundation and fully integrated throughout, strong leadership and cultural change is essential. Senior leaders should communicate and demonstrate an increased risk appetite with respect to the use of innovative technologies, both internally and in the market. This should be supported by clear internal guidelines to enable controlled experimentation, fast failure and scale-up. Internal innovation improves processes and increases efficiencies at the regulator while giving officials experience and understanding of the technology being used in the market.

Recommendation 2

Building and hiring fit-for-the-future talent

To begin closing the gap between the market and its regulatory overseers, new supervisory skills are necessary. Supervisory requirements are not the same as they were in the past. To effectively supervise in a digital economy, regulators need a more diverse set of skills across technology, data science, behavioural science, change management and actuarial science, as well as the traditional disciplines of law and economics, commerce, banking and finance. Many regulators have already invested significantly in building internal capacity, but more can be done. Importantly, when overseeing a fast-paced digital financial sector, it is not always possible to build the right capacity at the right time. As a complement to skills building, regulators also need to consider how else to acquire or leverage the right skills. They could:

- **Revise hiring practices to attract and retain diverse talent.** Regulators are often focussed on recruiting top graduates and developing them across their career. This approach should be complemented by creating more opportunities for experienced hires that bring fresh perspectives and experience, and by removing barriers to the exchange of talent between industry and the regulator.
- **Continue to build capacity to strengthen confidence and adaptability.** Strengthening internal capacity can help to build the technical and analytical skills needed to evaluate and adopt new ideas and to understand and supervise changing markets. This can be done through targeted training, peer learning, and knowledge exchange specifically targeting new skills and knowledge – all of which should be planned, measured and evaluated.



Recommendation 3

Emphasising consumer protection

In a digital environment, consumer protection should be central to all regulatory intervention, and consumer experience should drive regulatory action. Although the ultimate goal of prudential regulation is ensuring the soundness of financial institutions so they can benefit end-users, consumer protection can sometimes be viewed as an isolated consideration.

However, in a digital financial system, it is even more apparent that consumers should be at the centre of regulatory considerations. Risks to consumers are heightened in a digital environment, with more channels for crime, fraud and poor behaviour, while data sharing brings increased risk from additional financial sector participants. The failure to appropriately protect consumers can directly damage the stability of financial institutions and indirectly erode the trust the financial system is built upon.

At the same time, consumer protection considerations need to be continually weighed against other regulatory and policy priorities. Consumer-focused activities, such as complaints handling, can also provide insights into broader challenges within the financial institution or sector. As such, we recommend regulators prioritise:

- **Greater collaboration between consumer protection functions and broader supervisory functions** to ensure that consumer protection factors are considered across functional and institutional areas of supervision and regulation. This could mean, for example, including consumer protection or market conduct staff in on-site inspections or deep dives, integrating consumer-focused metrics in reporting and consulting with consumer protection staff when developing guidelines or regulation.
- **Leveraging insights obtained from consumer protection activities** to inform areas for intervention across supervisory and regulatory functions. Particularly relevant are complaints data and complaints handling in financial institutions. Where there is a third-party complaints authority, it is essential that information and insights are exchanged regularly between the authority and the regulator.
- **Adopting an outcomes-oriented consumer protection approach.** An outcomes-oriented consumer protection approach, such as South Africa's 'treating customers fairly' can unite regulators and provide the foundation for better integrating consumer protection across the regulatory universe. It also provides a guiding principle for the financial sector, and a clear basis for regulatory action where novel consumer protection risks arise – more likely in a digitised financial sector.

Recommendation 4

Reconsidering and addressing liability

As finance digitises, new channels and opportunities for fraud and scams are emerging. The very technologies that improve consumer experience such as fast payments and generative AI, also make scams and fraud easier and more lucrative for cybercriminals. The increase in fraud and scams undermines trust in the financial sector and the digital economy more broadly. Existing liability regimes, often reliant on individual contracts or based on old technology, may be insufficient to address the current reality and to restore trust.

New liability models are emerging from the UK, Singapore and the EU, however, local responses will not be effective unless they are context sensitive; there is no one-size-fits-all approach, and there is no global consensus on the appropriate response. In addition, a liability approach cannot be adopted in isolation but must be considered as part of broader range of measures to protect consumers and appropriately allocate risk in the digital economy. We recommend that regulators reconsider how liability is allocated among the various participants in their financial sectors, and in doing so:

- **Consider the local market structure and identify where the risk is most concentrated within the financial system.** Evaluate the existing legal underpinnings for liability and mechanisms for consumer recourse and understand the capability and resources of the various actors required to identify and address scams and fraud, including FSPs, regulatory authorities, consumers, third party providers and law enforcement.
- **Understand and evaluate the various options,** including those being developed in other markets, and critically assess what is most appropriate in the local environment. This would include balancing the need for consumer compensation against other policy objectives, including increasing financial access, promoting financial innovation and meeting consumer needs. Imposing strict or higher obligations on FSPs may constrict innovation or market entry, or lead to providers excluding or refusing to serve consumers deemed at higher risk of scams. In addition, policymakers would need to weigh any costs to providers, including compensation costs, infrastructure improvements and administration costs against the benefits to consumers and the system as a whole.



Recommendation 5

Recommitment to proportional, outcomes-focused, risk-based regulation and supervision

In a fast-moving environment, rule-based regulation is in a constant state of catch up. At the same time, a one-size-fits-all approach to regulatory requirements can cause distortions within the market, in particular acting as a barrier to entry given that the costs of regulation tend to be heavier on smaller and newer financial institutions.

Global best practice in regulation and supervision promotes a principles-based, outcomes-focused approach. Principles-based and outcomes-focused approaches are more flexible and future-proof than strict rules and enable the level of flexibility and agility necessary to regulate innovative businesses and the application of new technologies. Outcomes-based requirements enable incumbent and new entities, and in turn their supervisors, to be more flexible in using technologies to meet regulatory expectations. An outcomes-based approach also enables the application of proportional regulatory requirements to smaller, less risky entities, given that the same regulatory outcomes can be achieved with less oversight and fewer compliance requirements.

Risk-based supervisory approaches prioritise addressing the areas of highest potential harm at any given time, enabling regulators to allocate resources most efficiently to areas of greatest impact. Many regulatory institutions have moved towards these more flexible approaches; however, these approaches are not always fully embedded. As such, we suggest several priorities for regulators:

- **Establish a shared set of guiding principles and target market outcomes** at regulator level, helping to ensure alignment and clarity on what the regulatory goals are. This will enable internal departments and regulated entities to focus on achieving the broader regulatory goals, even without detailed rules. This will also lay the groundwork for systematically shifting existing regulation and legislation towards principles-based instruments.
- **Support compliance with these principles by providing interpretive guidance.** Guidance notes assist participants navigate areas of uncertainty and increase ease of compliance. Guidance notes are particularly useful where innovation is outpacing regulation. This approach will allow regulators to remain agile and responsive in an evolving financial landscape.
- **Adopt proportionate regulatory requirements and supervisory intensity** (including capital requirements) for FSPs based on the scale, complexity of, and risk profile of institutions, ensuring that risks are systematically and dynamically assessed.



Conclusion

An inflection point for regulators in emerging markets

Technological developments provide regulators with an opportunity to harness technology to better serve their mandates. However, the fast moving nature of developments, and underlying gaps in regulatory structures and skills, means that there is a substantial risk of emerging market regulators being left behind in both the capability and capacity to deliver the outcomes for which they are constituted.

The time to act is now, and these recommendations provide a necessary, albeit challenging, pathway for regulators and policymakers to ensure they are equipped to navigate and regulate the digital and tech-driven markets that they oversee.

