FINTECH, FINANCIAL INCLUSION, AND CYBERSECURITY: TACKLING THE CHALLENGES

On 16 April 2020, Toronto Centre hosted a virtual discussion on whether and how financial regulation and supervision can enhance the benefits of FinTech for financial inclusion and gender equality.[1]

This followed a similar roundtable discussion hosted by Toronto Centre in October 2019 during the IMF and World Bank autumn meetings, which explored the benefits of FinTech for financial inclusion and some concerns relating to risks arising from the use of FinTech to consumers, financial inclusion, financial institutions and financial stability.[2]

RECORD OF PROCEEDINGS

The participants at the April 2020 roundtable discussed some of the remaining challenges identified at the earlier roundtable. Two issues dominated the discussion – views on whether there is any tension between the regulation and supervision of FinTech activities and the ability of FinTech to enhance financial inclusion and gender equality; and the impact of the COVID-19 outbreak on digitalization in the financial sector.

The roundtable was moderated by Alan AtKisson, Assistant Director General at Sida, who opened the discussion by introducing the new dimension of how the COVID-19 outbreak might affect FinTech and financial inclusion.

Panel Session

Stefan Ingves (Governor, Riksbank; Chair, Toronto Centre) opened the discussion by observing that an increase in financial inclusion depends in part on people trusting financial institutions and services. If people do not trust the financial system, they will opt out of it – they will be too afraid to lose their money and instead keep it in physical form.

One important way to instill this trust in the financial system is to have proper and sound regulation and supervision. People will know that they can trust well-regulated financial institutions and services. In this regard, there is a synergy rather than a trade-off between regulation and financial inclusion – proper regulation and supervision are a prerequisite for financial inclusion.

Regulation and supervision may not be sufficient to solve all the problems with financial inclusion. However, tilting the playing field by giving favourable treatment to FinTech-based providers may not

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[1] See attached list of attendees and issues note.

[2] The record of the October 2019 roundtable discussion can be found at: https://www.torontocentre.org/Files/NewsResources/11-26-2019/Roundtable_Discussion_Proceedings_Oct17.pdf
See also the Toronto Centre Note on “Supervising FinTech for Financial Inclusion” that developed further some of the issues covered in the October 2019 discussion: https://res.torontocentre.org/guidedocs/Supervising%20FinTech%20to%20Promote%20Financial%20Inclusion.pdf

be a good way forward. As past experiences of European industrial policy indicate, it is very difficult for the public sector to "pick winners" among companies.

Every country has its own national context, and therefore has to analyze what steps the public sector should take to tackle its specific challenges. In Sweden, the COVID-19 outbreak has accelerated the move toward a cashless society. But this has created a new type of financial exclusion as many people, especially the elderly, are finding it increasingly difficult to make their daily payments. That is why the Riksbank has begun to explore whether to launch a central bank digital currency, designed in a way to make it simple for everyone to use, and thus to promote financial inclusion.

That said, there are some beneficial aspects of cash that are difficult to reproduce in digital form – for instance its robustness and independence from electric power supplies, and the ease with which an instant payment can be made by simply handing cash over to another person. So, we need to ensure both that cash does not die out completely and that central bank digital money is as safe, efficient, and inclusive as possible, as well as being risk-free because it is backed by the government.

Ceyla Pazarbasioglu (Vice President, Equitable Growth, Finance and Institutions, World Bank Group; board member, Toronto Centre) noted that the COVID-19 outbreak has underscored the urgency of expanding the use of digital financial services and utilizing FinTech applications to keep financial systems functioning during this time of social distancing.

This crisis differs from the previous global financial crisis, during which problems in the financial system constricted economic activity and employment. Today, we are seeing the impact of COVID-19 on falling demand, reduced input supply, the tightening of credit conditions, and rising uncertainty. These temporary disruptions in economic activity and employment threaten to have a devastating impact on businesses and households, and to generate financial instability.

As governments look to provide financial assistance to firms and households, digital payments can help move funds in a faster, more secure, and more efficient manner. FinTech can help governments reach vulnerable people with social transfers and other forms of financial assistance, especially during times when transportation and movement around the country is unsafe or limited and when face-to-face contact is discouraged. Once funds are received, investment in a digital ecosystem enables consumers to transfer funds, pay bills, and pay for goods and services from their home, or in a market or store setting, with limited physical contact.

This is also true for cross-border payments in the form of remittances, which are an important source of income for the poor. Remittances are estimated at US$600 billion a year, with 80 percent of them going to women. Digital financial services can help to reduce the cost of remittances – by almost half in some cases (from 7% to 3.5%). It is imperative to continue these efforts to reduce fees and to offset at least some portion of the current decline in cross-border payments. It is also critical that countries prioritize maintaining the availability of remittance services to the public, including by declaring remittances service providers as "essential" when determining what businesses are allowed to stay open during the crisis.

Overall, the contribution of FinTech to financial inclusion could also benefit from more attention to women's needs – which may not get adequate consideration from the largely male-dominated industry. A gender perspective and gender-disaggregated data could help the development of better products, services, and delivery channels.

Roundtable Discussion[3]

Is there a trade-off between regulation and maximizing the benefits of FinTech for financial inclusion?

Many participants echoed Stefan Ingves' argument that the importance of trust in money and in payment systems means that there is no trade-off between regulation/supervision and the growth of FinTech to support financial inclusion. Indeed, there can be no meaningful financial inclusion without financial stability.

In the midst of the current crisis and as the recovery begins, there will be pressures to deregulate in the name of economic growth and inclusion. But this would be a false trade-off. Once trust is lost, it is difficult to regain. A FinTech activity that allows a compromise of customer data or is unable to transact because of system outage after a cyber-attack will lose trust and may be unable to regain it.

One participant offered an insurance-related example here. For many consumers, digitally-enabled inclusive insurance products are their first experience of insurance. New digital products will have a significant impact on the future growth of the market. But these new technologies bring new risks. The increasing amount of consumer data collected, for example, creates the risk that some consumers could be excluded if automated decision-making algorithms were to result in unfair discrimination. This is of particular concern when you apply a gender lens.

Good regulation and supervision can therefore be seen as one of the core pillars supporting FinTech and financial inclusion, together with an adequate legal structure, a system for electronic identification, and mobile and internet connectivity.

It was recognized that regulation and supervision impose costs on financial institutions. One example offered by a participant of the nexus between regulatory cost and financial inclusion was the move towards classifying some popular FinTech products, such as digital stored value, as deposits covered by deposit insurance in jurisdictions such as Kenya and Nigeria. This is good from a consumer protection and financial inclusion perspective. However, providing coverage in this manner is complex and challenging operationally for deposit insurers, and imposes a cost burden on the providers of these products.

Reducing the costs of regulation could help new entrants to improve the competitiveness of financial services and enable existing providers to expand the services they offer. Costs can be reduced through a combination of a clear regulatory system, clear guidance, and level playing fields; using FinTech to increase the efficiency of supervision and compliance (SupTech and RegTech); and working with the industry and other supervisors to enhance international cooperation and to establish the basics of common international standards, capacity building of staff in new emerging technology, and information sharing in areas such as cyber security, data protection, and outsourcing.

However, some participants also mentioned examples of where regulation and supervision might discourage the use of FinTech and might thereby diminish the potential to increase financial inclusion:

[3] The discussion was conducted under the Chatham House rule – the themes reported here reflect the sense of discussion but do not attribute observations to individual participants.

- The regulatory framework generally favours incumbent financial institutions (incumbent bias) and denies entry to a number of FinTech firms that might bring digital services to large parts of the population. This may be particularly the case for FinTech banks that would benefit from deposit insurance, where entry barriers are set at a high level.
- Some FinTech initiatives are stymied by a knee-jerk concern about the potential for money laundering, even though digital money is more traceable than cash.
- Similarly, over-playing valid concerns over access to data and continuity of service may inhibit the use of cross-border cloud computing.
- Attempts to close down some routes for money laundering (for example men using their partner's identification to transfer funds) may make it more difficult for innocent women to open and use bank accounts.

The impact of COVID-19

Participants noted various ways in which the COVID-19 outbreak was speeding up digitalization – governments making safety net pay-outs online, the use of digitally-enabled agents as a replacement for physical bank branches, fears of handling cash, higher limits on contactless payments, improvements in technology for customer due diligence, increases in micro-loans granted from digital platforms, much of the financial industry working successfully from home, and social distancing.

Most of these initiatives have also expedited financial inclusion or could be leveraged to do so. Resilient and FinTech-enabled financial systems have the potential to increase financial inclusion, although it should also be recognized that new policies and new channels of intermediation that spring up during a crisis could turn out to be ill-judged.

However, in some countries the COVID-19 outbreak has exposed weaknesses that will need to be addressed. In some cases, the absence of digital payment systems has made government safety net pay-outs inefficient and difficult to handle; and in any case those outside the financial system have had to queue at bank branches to validate their identification and to receive cash payments. Similarly, those lacking digital means of payment have had to queue at remittances bureaux or have found these bureaux closed and therefore been unable to send remittances at all.

In some countries, inadequate identification protections have opened the process of digital payments to fraud. And in some cases, limited connectivity has exposed inequalities that constrain financial and other types of inclusion.

This all points to the need for investment in infrastructure, and viable and trustworthy FinTech solutions.

There are also balances to be struck by supervisors between conduct issues and prudential considerations relating to the COVID-19 outbreak and its impact on financial inclusion. For example, imposing restrictions on insurance coverage (such as exclusions for COVID-19-related risks) and taking a tough line on borrowers with repayment difficulties may be attractive from a prudential viewpoint but equally unattractive in terms of treating customers fairly.