Regulation and Digital Financial Services

The Role of Regulators

in Building Consumer Demand for Mobile Money

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Introduction

The primary role of a financial regulator is to maintain the safety and soundness of a financial system. However, financial regulators are now embracing financial inclusion as a new goal in recognition that healthy financial systems should serve the needs of the majority of the population. Promoting financial inclusion is a new and different role for financial regulators. It raises new challenges such as how to encourage banks to serve low-income clients who offer few obvious profitable opportunities, and how to regulate mobile network operators (MNOs) and other innovative providers offering financial services.

Traditionally, regulators would have focused on devising risk-based regulations for digital financial services (DFS), so as to ensure sound, supportive regulatory frameworks for the new products and services, with little thought to the uptake and use of services. However, a growing number of regulators see DFS as having great potential to support their financial inclusion goals, are keen to see it succeed, and are actively working to ensure end-users are provided with safe, affordable and practical payment options.

Low uptake and inactive users are the primary challenges facing DFS in most developing countries. In some cases they are due to restrictive regulations. However, they have mostly occurred because providers have focused on availability and accessibility (i.e., through developing large agent networks and mass sign-ups of end-users) without understanding the real needs and desires of end-users. The DFS offered are often not appropriate, affordable or well understood by consumers.

In this environment, experience tells us that market forces alone cannot be relied upon to deliver products suitable for end-users' needs. As an example, saving for retirement is clearly important, but people may fail to do so without incentives. To create the incentive to use DFS, financial regulators must first work to understand and build consumer demand by seeking to minimise the gap between what market forces may provide and what end-users may need, understand, want and afford. Building consumer demand is critically important to the success and sustainability of DFS ecosystems.

Regulatory efforts to understand and build consumer demand should focus on three key areas:

1. Understanding the financial needs of the unbanked and under-banked;
2. Promoting financial literacy to encourage the uptake and use of DFS; and
3. Being an enabling regulator by supporting DFS providers in experimenting and testing new products.

1. Understanding end-users' needs

Regulators can assess a DFS product's potential for promoting financial inclusion by considering how well the initiative focuses on **local context** and the **customer value proposition**. Any DFS that ignores local context and the customer value proposition is highly unlikely to succeed, and consequently regulatory efforts to promote such DFS will also fail.

Local context

To determine whether a product will be successful, one needs insight into the local customer base, locally specific needs, and the services already available and used by customers.[1] For example, in the Philippines, the principal demand is to move money between urban and rural areas and from overseas. MNOs have therefore enjoyed a distributional advantage over banking networks. In contrast, in South Africa, consumers either have a bank account to receive their salary or access to a cash-out facility provided by the Government. Consumers in the South African market have far less incentive to replace their existing methods of receiving funds, compared to their Philippine counterparts.[2]

Customer value proposition

Assessing the customer value proposition means making sure that new product offerings are aligned with services people actually need and will use. Capturing customer perceptions through surveys is important, both of existing access to financial services (formal and informal) and of what is valuable in a new product or service. However, care should be taken in interpretation because results depend on the precise questions asked.[3]

Many regulators already play a role in surveys and research on financial service access and use. For those that do not, there are many ways for them to understand these issues by speaking to providers or looking at existing research such as FinScope Surveys, Financial Diaries and Financial Inclusion Tracker Surveys that are increasingly available in many countries. Regulators can also push for more of these issues to be addressed in regular government household surveys.

1. Debbie Watkins, 'Context and Culture: Designing Relevant Financial Services,' 13 August 2013. Available from http://www.cgap.org/blog/context-and-culture-designing-relevant-financial-services
2. Ben Davis and John Owens, 'POS vs. Mobile Phone as a Channel for M Banking,' *MicroSave* Briefing Note #66.
3. Lesley Denyes, 'How Do Smallholder Farmers Access Information,' 31 January 2014. Available from http://www.cgap.org/blog/how-do-smallholder-farmers-access-information

2. Promoting financial literacy

Promoting financial literacy can help build consumer demand by increasing understanding of how, why and when to use DFS products.

Financial literacy programmes need to be tailored to the needs and circumstances of the under-banked and in a language the financially excluded can understand and with which they feel comfortable. New products should not simply be built and rolled out along with training on how to use them; rather, it is necessary to focus on how DFS can help consumers and to address consumer fears about using the services.

The regulator's role in consumer education can be very influential and must be considered carefully. Clear public statements on the safety of DFS can influence public opinion and should be provided fairly for all DFS providers based on the regulator's assessment. Alternatively, regulators may choose to incorporate DFS in their general financial education efforts. For example, the Reserve Bank of Malawi, in cooperation with the Ministry of Finance and the Malawi Institute of Education, has implemented a financial literacy syllabus as part of Malawi's secondary school curriculum, and there are plans to introduce such programmes at the tertiary level.

3. Being an enabling regulator

Regulators can encourage the development of successful and sustainable DFS ecosystems by a number of means, including the following:

3.1 Supporting innovation in the DFS market;
3.2 Encouraging the move of cash payments to DFS channels, particularly with government payments;
3.3 Developing interoperable/interconnected systems; and
3.4 Enabling partnerships between the various market players, such as banks and MNOs.

3.1 Supporting innovation in the digital financial services market

The Philippines' central bank, Bangko Sentral ng Pilipinas (BSP), is renowned as an enabling regulator. It focuses on creating space for private sector innovation in DFS by adopting a regulatory approach of allowing the private sector to learn and test, and it has regulations for mobile money that enable MNOs to compete with banks. Two main benefits of the 'test and learn' approach are increased competition, which leads to a range of greater services, and decreased remittance costs, which supports the uptake of DFS. The latter is particularly important in the Philippines where external remittances comprise 10 percent of GDP and internal remittances are substantial, with people working in urban areas regularly sending money to family members in remote rural areas.[4]

BSP also established a new supervisory unit bringing together the skills of regulators from its IT and banking supervisory areas to strengthen its regulatory capacity to oversee e-money issuers. BSP is an example of a central bank that has sought to build regulatory frameworks and supervisory capacity suited to new DFS—rather than forcing innovative financial services to conform to the existing regulatory architecture.

3.2 Shifting government payments to digital financial service channels

Governments already use mobile money services to make salary, pension and welfare payments. In India, mobile money is being used to deliver welfare and social aid payments; in the United Republic of Tanzania, the Government accepts tax payments through mobile money services; and Ethiopia recently launched its first nationwide mobile money service, M-BIRR, which will be used to deliver welfare payments to poor households in rural areas.

Regulators can work with governments to shift government payments to DFS payment systems. Doing so will help end-users build experience, trust and familiarity with DFS and at the same time bring payments closer to the beneficiaries. Regulators can support such initiatives through, for example, instituting policy changes to support the required payments infrastructure for mass payments and ensuring that the DFS payment systems used are safe and stable. They can also encourage payments be provided in a manner that supports the use of DFS and promotes financial inclusion (i.e., by not requiring beneficiaries to withdraw all of their funds at once or offering them a low-cost savings account in which to store the funds).

4. Jeanette Thomas, 'Regulation Spurs Innovation in the Philippines,' 5 November 2012. Available from http://www.cgap.org/blog/regulation-spurs-innovation-philippines

3.3 Developing interoperable/interconnected systems

The development of payment system infrastructure that enables interoperability and interconnectivity will promote consumer demand. Experience suggests that regulators need to encourage DFS providers to move towards interoperability because market forces alone are unlikely to provide sufficient incentive in the medium-term. The case for interoperable systems is growing stronger with the success of the United Republic of Tanzania; however, in the absence of strong regulatory leadership on this issue, providers are highly unlikely to prioritise interconnection with competitors.

3.4 Enabling partnerships between various digital financial service market players

Partnerships between banks and non-banks allow for deeper product offerings and a greater range of services, including savings, credit and insurance. Deeper product offerings can also contribute to the sustainability of DFS by broadening the scope of services available to consumers and revenue streams available to providers.

However, regulators may find themselves in a situation where they have a regulatory mandate over one of the participants in a partnership (the bank) but not the other (the MNO), which may, for example, fall under the jurisdiction of a telecoms regulator. Therefore, regulators need to innovate both in rule-making and in cross-regulatory collaboration in order to effectively regulate such partnerships.

Conclusion

If regulators focus only on determining how to devise risk-based regulations for DFS, the result may be sound and supportive regulatory frameworks for services with low uptake and limited success. A dual regulatory focus on ensuring safe and sound financial systems while promoting financial inclusion starts with understanding and building consumer demand so that DFS innovation can reach the financially excluded with safe, accessible and useful services.

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