Comments to BCBS Guidance on the application of the Core principles for effective banking supervision to the regulation and supervision of institutions relevant to financial inclusion

General remarks

- **We appreciate the effort made by the Basel Committee** to provide guidance on the development of effective regulatory and supervisory frameworks taking into account the objectives of financial inclusion. We welcome the opportunity to comment on this and support the identification and promotion of best practices across jurisdictions.
- **However, this Guidance might have a limited outreach.** The BCBS has traditionally focused on ensuring a level-playing field for internationally active banks, preventing national supervisors from engaging in a race to the bottom that might ultimately undermine global financial stability. However, institutions relevant to financial inclusion are often small and purely local. Therefore, the threat created to global financial stability by these and the likelihood that cross-border spillovers may arise is limited.
- **The principle of proportionality must be carefully assessed and applied.** The document suggests setting differentiated requirements for different types of institutions. We believe that this would create an unlevelled playing field and give rise to regulatory arbitrage between institutions that engage in similar activities. In our view, it might be more sensible to apply proportionality not on the basis of the type of institution, but instead in regards to the different risks levels posed by clients.
- **The Guidance provides an uneven coverage of products, services and business models.** It focuses mainly on microcredit, while it barely covers other aspects that are essential to promoting financial inclusion (i.e. new digital services, the agency model or the use of big data are barely touched upon or not even mentioned).
- **Supervisory and regulatory regimes for financial inclusion should not be static, as this is a fast-changing environment.** An important effort should be made to monitor the build-up of risks. This is essential to ensure a level playing field among market participants while not hampering financial innovation.
- **The implications of the consultation paper might impose an excessive burden on both relevant institutions and banking supervisors and regulators in smaller, less developed economies.** In the end, a deep knowledge of the functioning of numerous and diverse sectors, together with enhanced coordination and cooperation among all relevant authorities is a prerequisite before entering into the fine-tuning of supervisory techniques and minimum requirements. International institutions should support national authorities in the application of this and future guidance.

Specific issues

A. Licencing criteria

We support the Basel Guidance in its proposal that non-financial firms that provide financial services as one of its primary sources of activity should be required to either become registered or licensed. In some cases, this might require a non-financial firm to establish a separated legal entity.

We also believe that the elaboration and publication of a list of registered or licensed institutions can significantly contribute to raise consumer confidence and awareness. Furthermore, this list should be updated on a regular basis. This requires a significant effort for supervisors to fully understand the different business models of licensed/registered institutions, and the monitoring of the emergence of new products and services to avoid an unnecessary stifling of innovation.

Finally, the establishment of a graduated set of licensing criteria for different types of institutions must be accompanied by a close monitoring of when an institution or sub-sector has evolved to the extent that the risks that they pose require the fulfilment of a more stringent set of criteria.

Related Core Principles: 1, 4, 5

B. Cooperation and coordination

The Basel guidance correctly signals the importance of establishing adequate cooperation and coordination mechanisms among regulators and supervisors. Coordination is especially relevant between authorities with responsibility over banks, nonbank financial institutions and non-financial firms relevant for the delivery of such products (for instance, the telecommunication agency). Coordination is also required with the financial intelligence unit (for customer due diligence) and with the authority with consumer protection responsibilities.

A more fluent and periodic dialogue could facilitate the identification of new risks in this fast-changing environment, as well as help overcome the limitations of the prudential supervisor to fully understand the business models of all the institutions that are relevant for financial inclusion. According to the Range of Practice Survey (BCBS, 2015), there is significant room for improvement on this front, given that a majority of respondents stated that inter-agency coordination takes place “only when needed”.

Furthermore, coordination among regulators is also of the utmost importance in the drafting of reporting requirements, to avoid overlaps and unnecessary duplications that might impose an excessive burden on some institutions, especially those of a relatively smaller size that are relevant to financial inclusion.

The Peruvian initiative “Modelo Perú” to foster Financial Inclusion might be a useful example of the benefits of this kind of collaboration. The collaboration between the public and private sectors (including commercial banks, other financial institutions and telecommunications) companies has led to the recent launch of a common mobile-payment platform (BIM), with a large potential to expand financial inclusion in Peru. This has been possible thanks to a close cooperation between relevant authorities, mainly the prudential banking authority and the telecommunications agency.

Related Core Principles: 3, 10, 28

C. Supervisory approach

We have some misgivings on the BCBS proposal to substitute individual supervision by monitoring at sector or market level, primarily off-site. We acknowledge that supervisors might face significant resource constraints when dealing with numerous, small and more diverse financial institutions and third parties that are relevant to financial inclusion, and that this significantly hinders the conduct of on-site individual supervision on the same frequency as for banks.

However, we would suggest that supervision is conducted on an individual basis whenever it is possible, and at least for all institutions that take deposits from the public. Placing supervision at market level might hide the build-up of great risks at institution level. It is likely that within the same market or sector, different players have different risk appetites and therefore undertake a more or less aggressive strategy in the conduct of their operations.

On the other hand, we strongly advocate for supervision to be at consolidated level in order to identify and act upon risks posed by unregulated activities within the group to the regulated entity or to financial stability. For an appropriate implementation, consolidated supervision also demands supervisors to raise concerns at an early stage and communicate them to other supervisors or relevant authorities as soon as they are identified.

On the issue of corporate governance, a periodic interaction between supervisors and institutions' Boards or senior management could facilitate a mutual understanding of the new reality. It could help the supervisor gain a better understanding of the business models and aid the institutions in meeting new requirements. If individual meetings are not possible, interaction with industry representatives might be a feasible alternative.

The results of the Survey show that a large number of respondents, especially among low-income countries, replace differentiated supervision by a differentiated approach to licensing. Due to the fast-changing nature of risks in this context, we would recommend that an effort is made to tackle this issue, which is not touched upon in the Basel Guidance. Ideally, the supervisory approach would not only differentiate on the basis of the license/category of each institution, but instead be based on the risks posed by each institution and its target customers.

Related Core Principles: 8, 9, 10, 11, 12

D. Risk management and capital adequacy framework

The establishment of an appropriate risk management framework as well as the set-up of minimum requirements for capital, liquidity or operational risks requires a deep understanding of the business models and the specific dynamics of assets and liabilities in institutions targeting unserved and underserved customers.

In this area, a careful application of the principle of proportionality is needed. The document suggests setting differentiated requirements for different types of institutions. The size of an institution seems to be a critical element in determining the regulatory burden that they should bear. However, this issue should be better addressed from the point of view of the business activities of the institutions and the risks of the clients they target. Otherwise, proportionality is likely to create an unlevelled playing field between institutions that engage in similar activities with similar customers, giving rise to regulatory arbitrage. This could ultimately jeopardize financial stability as well as consumer confidence in the financial system, ultimately undermining the objective of enhancing financial inclusion.

A rightly noted issue is the additional difficulty in the risk management process created by the intensive use of third parties (agents and partners) by institutions relevant for financial inclusion. It must be clear for financial institutions that they hold the ultimate responsibility to supervisors and customers. Further clarification would be needed on how to put in place appropriate mechanisms to ensure the transmission of the culture, values, risk appetite and risk management processes and tools.

Having said this, institutions that are relevant for financial inclusion in most cases do not operate in foreign markets. They do not directly put at risk global financial stability, which is the basis on which minimum requirements for different types of risks are set for globally active banks under Basel standards. The trade-off between the aforementioned risks of setting differentiated requirements (in terms of potential arbitrage opportunities) and the potential benefits arising from having minimum standards at global level might need to be reconsidered.

Related Core Principles: 14, 15, 16, 17, 18, 24, 25.

E. Abuse of financial services (AML/CFT)

We support the risk-based approach that the Guidance proposes for AML/CFT rules, consistent with the standards of the Financial Action Task Force (FATF). Where clients have a low-risk profile, the regulator should have the option of permitting the application of simplified CDD measures and should do so where appropriate. This is important as overly-strict CDD rules can prevent unserved and underserved customers from accessing formal financial services and products and potentially increase the risk of money laundering and terrorist financing by shifting transactions to the informal economy. As stated by the Basel Committee, this should be matched with appropriate operational restrictions, such as low-value limits or geographic restrictions.

Related Core Principle: 29