

## **Benjamin E Diokno: Regulations and policies to empower financial institutions and reach undeserved population through technology and innovation**

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the eCompareMo.com Finovation Event, Makati, 25 September 2019.

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Ladies and gentlemen, good morning.

Thank you for inviting me to share with you the BSP's key policy issuances and initiatives to promote financial inclusion in the Philippines and the regulatory framework on financial technology. This year's theme "Get all Pinoys #AcceptED!" is aligned with the BSP's policy objective of building an inclusive financial system for the Filipinos.

Through financial inclusion, we aim to cater to the unserved and underserved markets such as the low-income and marginalized, micro, small and medium enterprises, overseas Filipinos and their beneficiaries, agriculture and agrarian reform sectors, indigenous peoples, persons with disabilities, among others.

We, at the BSP, recognize the significant role that the fintech plays in driving the transformation of the traditional processes in the financial system through technology-driven innovations to unlock financial inclusion barriers.

We aim to develop a digital finance ecosystem that supports the diverse needs of all users in a manner that is secure, sustainable, convenient, and affordable. To support this goal, the BSP established the National Retail Payment System (NRPS), our flagship program for digital finance.

NRPS is built on three core principles namely interoperability, inclusiveness and "coopetition". Through the NRPS, regulated institutions are required to adopt transparent and fair market pricing of electronic payments, transition from exclusive bilateral to multi-party clearinghouse agreements and provide electronic fund transfer facilities in all available channels, among others.

It is a critical platform that will establish an interoperable ecosystem allowing seamless electronic fund transfers and payments between and among accounts. It aims to promote a "cash-lite" economy and ultimately improve the country's economic competitiveness.

The NRPS, and the payment ecosystem that is envisioned to arise from it, is positioned to be a platform for fintech innovations. Industry players can utilize fintech solutions and provide services within an organized, commercially-viable and efficient retail payment system.

Advances in technology have also enabled the development of solutions that enhance market reach and expand delivery channels. Through technology, people from all walks of life, including those in unbanked and underserved markets, can have access to formal financial services like online bills payments and fund transfers.

We cannot discount the crucial role that fintech companies play in this modern ecosystem. Fintech players are not competitors of our supervised financial institutions, but rather, are strategic partners to bring about greater efficiencies in the delivery of financial services.

Recognizing the benefits and opportunities from these technological innovations, the BSP aims to provide a regulatory environment that allows innovation to flourish, while at the same time, ensuring a safe and sound financial system that is beneficial to the general public.

The BSP's regulatory approach is shaped by three principles:

**One – We ensure that regulation is risk-based, proportionate and fair** – This simply means that regulation is calibrated according to the magnitude of risks identified in a defined activity, and not on the type of entity that delivers it.

This approach promotes a level playing field and ensures that beneficial innovations are not hampered by unwarranted and excessive compliance requirements.

**Two – We maintain active multi-stakeholder collaboration** – This is necessary in view of the multiplicity of players and multi-layered relationships among fintechs and varied financial sector players. It represents a “whole-of-government approach”, ensuring policy consistency and preventing regulatory arbitrage. Continuing engagement with industry players is also crucial to foster a shared understanding of risks, our financial inclusion goals and market conduct expectations.

**Three – We ensure consumer protection** – By this we mean innovations must work for the benefit of consumers, especially the most vulnerable ones, and those availing of financial services for the first time. Regulations must ensure that issues such as transparency, product suitability, security and confidentiality, are made paramount considerations in the design and deployment of digital solutions.

Fintech has immensely contributed to the enhancement of a financial consumer’s experience by transforming the delivery of financial services from branch banking to online banking, paper-based money to electronic money, and face-to-face customer verification to technology-aided know-your-customer process, among others.

In addition, Fintech transcends geographical barriers and enhances transparency, and reduces the cost of financial transactions.

In line with this, the BSP has identified the responsible promotion of FinTech as a priority agenda, thus, the establishment of a fintech roadmap covering three key areas, namely: Collaborative Engagements, Commensurate Regulations and Capacity Building.

**By collaborative engagements, we mean maintenance of active multi-stakeholder collaboration** – This is necessary in view of the multiplicity of players and multi-layered relationships among fintechs innovators and varied incumbent financial sector players. It represents a “whole-of-government approach”, ensuring policy consistency and preventing regulatory arbitrage. Continuing engagement with industry players is also crucial to foster a shared understanding of risks, our financial inclusion goals and market conduct expectations.

In crafting **commensurate regulations**, the BSP has implemented key policy changes espousing the principle of “proportionality.” This approach promotes a level playing field and ensures that beneficial innovations are not hampered by unwarranted and excessive compliance requirements.

For **capacity build-up**, the BSP continues to provide training and learning opportunities to fast-track the development process of our people to ensure that financial supervisors maintain the necessary knowledge, proficiency and competence to keep pace with the fast-evolving innovations. We are also exploring regtech and supotech solutions, including the use of artificial intelligence, machine learning, cloud computing and APIs, to enhance the timeliness and quality of our risk-based decision-making.

As part of BSP’s fintech roadmap, I would like to share the BSP’s test-and-learn approach or the regulatory sandbox as part of our supervisory toolkit in dealing with new and innovative technologies in the market.

Through the so-called regulatory sandbox, pioneering solutions and technologies can be

deployed in a live but controlled setting.

I will not go into each one of the steps but on a very high level, our “test and learn” approach has been proven to be useful in dealing with increasing digital innovations in the market and promoting development and innovation within the financial services industry.

It provides an opportunity for innovators to connect to banks and other players with clear authority from the regulators. Such an approach helps the regulators assess potential risks and accordingly decide how to regulate the new market, if needed.

Recent examples of entities which approached BSP and devoted time and resources to conduct controlled and calculated experiments of their products include: (i) a pioneering rural bank that engaged a cloud service provider for its core banking system; (ii) a foreign bank which partnered with an electronic money issuer to offer its mobile based deposit product; (iii) a universal bank which explores potential use cases of a tokenized cash; and (iv) a universal bank which utilizes the blockchain platform to push its financial inclusion initiatives.

Let me quickly walk you through the five key steps in BSP’s test and learn approach:

*The first step is to **allow for market to develop and innovations to take place.***

After engaging with fintech players, the BSP determines if the proposed innovation presents major regulatory concerns. This is where the BSP checks the eligibility requirements such as soundness and feasibility of the business model, the proposed solution is innovative and not covered by existing regulations and the proponent demonstrates sound track record as well as resources/capability to successfully launch the pilot.

*The next step is to **proceed with flexibility yet with caution.***

During this phase, the BSP set certain limits/parameters or safeguards before fintech players fully market their products and services. We allow these pilot projects to run within clear parameters i.e. specific test time periods, localized markets or geography and limited users. Likewise, risk management controls such as those covering cybersecurity risks, money laundering, consumer protection and other operational risks should be in place.

*The third step is to **understand operating and business model.***

As the product or service is being offered in the market, the BSP can have better understanding of the operating/business models as well as technical considerations.

*The fourth step is for the BSP to **adopt appropriate regulatory approach.***

Once the BSP fully understands the operating/business model as well as detailed mechanics of the innovative product/service, appropriate regulations are then issued.

*Lastly, the BSP **closely monitors developments and related issues.***

We continue to monitor developments and introduce supervisory enhancements, when necessary, to address emerging issues and risks.

Similar with the BSP’s existing regulatory framework and supervisory approach covering banks and other financial institutions, the BSP also applies the same framework and approach that is commensurate to the FinTech’s risk profile and systemic importance.

This framework incorporates the following policy considerations:

**First is Prudential Objective** – In determining how BSP should supervise FinTechs, the safety

and soundness of the individual institution, the stability of the financial system, the advancement of financial inclusion, and the undue regulatory burden are all taken into consideration.

**Second is the Landscape of the Financial System** – In order to draw a holistic supervisory approach, BSP needs to have information on the financial ecosystem, particularly FinTechs. These include: the asset size, business condition like liquidity, profitability, capitalization, among others).

**Next is the Risks Faced by FinTech** – Considering their own business peculiarities, it is very important to also identify the risks specific to FinTech operations, these may include cybersecurity risk and AML risk, among others.

**And lastly** – Once we have identified these important information, we will now employ appropriate risk management standards based on the FinTech's business model, risk profile and degree of systemic importance.

The ongoing challenge for the BSP is how to stay ahead of the curve when it comes to emerging financial technological innovations.

In the same way technology is changing the financial industry, the BSP is also adopting innovations to enhance the way we regulate and supervise financial institutions.

This is through the use of Regulatory Technology (RegTech) solutions aimed at enabling the BSP to have a more intensive, risk-focused and forward-looking supervision while easing BSFIs' regulatory compliance burdens.

We are exploring regtech and supotech solutions, including the use of artificial intelligence, machine learning, and APIs, to enhance the timeliness and quality of our risk-based decision-making.

In fact, we are now in the final stages of pilot implementation of two RegTech solutions. The first one is **an automated complaint-handling system using a chatbot** with the primary objective of improving the way customers lodged complaints against financial institutions.

**The second is an API system** that automates the collection, processing and analysis of data from supervised institutions. Previously, banks were burdened by an extensive and time-consuming validation process, involving more than 240 Excel-based data entry templates with 100,000 plus data points. The resulting delays and the scope for human error posed complications on our data and statistical compilation operations. With this modern API system, manual intervention is eliminated since data sorting, sanitation and validation processes are fully automated and secured. With the same 7,000 data validation rules still being applied, processing time of filed returns was cut from more than 30 minutes to just 10 seconds each, thereby streamlining the entire end-to-end process of regulatory reporting and validation.

On the other hand, for the less sophisticated supervised entities that cannot immediately migrate to the API-based reporting, we developed a central automated reporting environment referred to as the FI Portal. The FI Portal provides a single electronic platform upon which FIs can submit reports, receive feedback on its acceptability, and exchange correspondences with the BSP on matters related to report submissions. It offers a more secure encrypted process of submission through a web facility where supervised entities can upload their reports instead of sending them via regular email.

We are also undertaking major organizational reforms and initiatives for a more proactive supervisory stance.

We have also recently set up a bigger, better and more agile Financial Technology Subsector to

ensure the operational as well as cyber-resilience of the financial system.

The new subsector in-charge of fostering responsible innovation in the financial services and payments industry is composed of two mission critical departments.

One is the Technology Risk and Innovation Supervision Department, which is primarily responsible for conducting onsite and offsite IT supervision of regulated entities.

It is also in charge of cybersecurity surveillance and promoting digital or fintech innovation through the BSP's regulatory sandbox.

The other department is the Payment Systems Oversight Department, which is mainly responsible for the payments oversight, licensing and policy development for a safe, efficient and reliable national payment system. PSOD is our lead in enforcing a holistic payment oversight framework, including the National Retail Payment System or the NRPS.

In conclusion, the BSP adopts an open and flexible approach to financial innovation, given its crucial role in expanding our financial inclusion agenda.

We are closely engaging with fintech stakeholders to gain a better understanding of their business models, processes and systems.

Our main challenge is to strike a balance between promoting and enabling a policy and regulatory environment for emerging financial innovations and ensuring consumer protection, security, and financial stability.

We aim to establish a forward-looking approach to ensure that regulatory and supervisory frameworks are in tune with emerging trends and developments.

Ladies and gentlemen, we are in an era where the biggest challenge is to keep up with the rapid pace of technological changes. To stay relevant is to remain proactive and vigilant in monitoring the advancements in technology and develop corresponding innovative solutions that intersects with traditional banking and other financial services and be agile.

We need to take full advantage of and effectively harness fintech innovations that can be used to unlock financial inclusion barriers and facilitate digital financial transactions in ways never imagined before.

Finally, the BSP, as your partner in promoting financial innovation and inclusion, will remain committed in supporting beneficial fintech innovations through an enabling policy and regulatory environment.

I hope that as we all do our part in this, we keep the convenience, safety, and well-being of the Filipino people in mind.

Thank you and I wish everyone a fruitful conference.