BANK FOR INTERNATIONAL SETTLEMENTS

Financial inclusion in the age of fintech: a paradigm shift[1]

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Fourth FSI-GPFI conference on standard-setting bodies and innovative financial inclusion: implications of fintech and other regulatory and supervisory developments

Basel, Switzerland, 25 October 2018

Introduction

It is my pleasure to open this biennial conference on standard-setting bodies (SSBs) and financial inclusion organised jointly by the Financial Stability Institute (FSI) of the BIS and the Global Partnership for Financial Inclusion (GPFI). This is the fourth such conference since 2012. At the two preceding conferences – in 2014 and 2016 – the focus shifted to innovative or digital financial inclusion. We will maintain that focus at this year's conference, but allow me to look back at what has changed over the years.

Fintech[2] has brought a new paradigm to the design and implementation strategies for financial inclusion. For example, smartphones for mobile banking and investing services are technologies that are making financial services much more accessible to the general public. I remember in Brazil 10 years ago, the major issue was how to use correspondent banking to lower the access cost for financing. Now, instead of focusing on the operational cost of bank agencies, we need to pay much more attention to the price of a smartphone and related softwares.

Indeed, financial inclusion has continued to improve globally. The 2017 Global Findex Database shows that, globally, the share of adults holding an account is now 69%, up from 51% in 2011 when the Global Findex Database was first released.[3] For this significant progress, we are quite grateful to the efforts of the GPFI and the broader financial inclusion community. Obviously, digital financial inclusion, or fintech developments in general, have taken root in a number of countries, and the benefits and risks are now becoming clearer to financial sector authorities compared with previous years.[4] A number of impressive developments can be observed, such as the progress in transferring money via mobile phone messages, or the widespread usage of mobile payment services (eg Alipay (Alibaba) and WeChat Pay (Tencent) in China processed more than $10 trillion worth of transactions in 2017, with 502 million users; and Paytm in India has over 200 million users). In parallel, cross-border retail payments have been facilitated by fintech (Alipay and WeChat Pay are accepted in 28 countries by retailers; and the Bank of Thailand and the

[1] I would like to thank Jermy Prenio for his contribution in preparing these remarks.

[2] Financial technology (fintech) is a new industry that uses new technologies and innovation to improve activities in finance and aims to compete with traditional financial methods in the delivery of financial services. Fintech companies consist of both startups and established financial and technology companies trying to enhance the services provided by existing financial companies.

[3] A Demirgüç-Kunt, L Klapper, D Singer, S Ansar and J Hess, *The Global Findex Database 2017 – measuring financial inclusion and the fintech revolution*, World Bank Group, April 2018.

[4] See eg Basel Committee on Banking Supervision, *Sound practices: implications of fintech developments for banks and bank supervisors*, February 2018.

Monetary Authority of Singapore are linking their mobile payment systems). Not all these developments are directly related to poor customers, but one can say that distributed ledger technology (DLT) has been reducing the need for intermediaries or validators (eg credit card authorisation) and is facilitating access to financial services. One important aspect directly affecting workers has been the significant reduction in the cost of remittances and cross-border payments, which is very important for emerging market economies (EMEs) (eg total workers' remittances jumped from $50 billion in 2002 to $250 billion in 2017, amounts representing 5–40% of national savings in poor countries). These new ways of transferring money have increased competition and put downward pressure on the more costly procedures using bank networks and SWIFT.

Fintech has also changed the way small businesses operate throughout the world, a major vehicle for promoting social inclusion. Trade finance has benefited from DLT technology to reduce both cost and processing time, from 20 days to a few hours (since digital agreements can be automatically executed when all parties have accepted conditions). The technology also reduces fraud. Firms in EMEs are experimenting with screening online borrowers with new credit scoring that could change risk management (access to payments record, social media behaviour, etc). In China, peer-to-peer (P2P) lending has experienced a surge in recent years, complementing the traditional financial services in funding underserved segments such as small and medium-sized enterprises (SMEs) and low-income households while offering attractive investment opportunities to smaller investors.[5] However, a significant number of Chinese P2P lenders have gone bust, leaving Chinese authorities to address the fallout, particularly vis-à-vis small investors.[6] This clearly illustrates that there are also fintech-related risks that, if not properly managed, could spoil the potential benefits of this innovation.

National authorities' interest in fostering fintech's potential benefits while mitigating its possible risks prompted the IMF and the World Bank to release the Bali Fintech Agenda[7] a couple of weeks ago, in order to outline the high-level issues that national authorities may consider in their domestic policy discussions with regard to fintech. Applications of fintech for financial inclusion are growing, as I have just illustrated. One can envisage that more granular individual information may change many aspects of policy intervention and increase its efficiency – for example, when policies need to target specific sets of firms (SMEs or startups) and/or specific income groups to reach the poor via eg means-tested conditional cash transfer (CCT) programmes.

Financial stability, financial inclusion and fintech

The Bali Fintech Agenda considers the interaction between financial stability, financial inclusion and fintech.

Promotion of financial stability leads to a resilient financial system that people trust. Since distrust in the financial system is one of the reasons why people are unbanked,[8] having a resilient financial system helps create an environment conducive to financial inclusion.

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5 L A Pereira da Silva, "Fintech in EMEs: blessing or curse?", panel remarks at the CV Meeting of Central Bank Governors of CEMLA, Asunción, Paraguay, 5 June 2018.

6 See eg https://www.ft.com/content/75e75628-8b27-11e8-bf9e-8771d5404543.

7 International Monetary Fund and World Bank Group, "The Bali Fintech Agenda", September 2018.

8 Demirgüç-Kunt et al (2018), op cit.

Implementation of effective regulation helps achieve a resilient financial system. In the context of financial inclusion, effective regulation helps ensure that expanding financial use and access is done in a manner that does not entail harm to financial stability.

Fintech can potentially contribute to both financial stability and financial inclusion. On the one hand, fintech is leading to new, more efficient and more accessible delivery channels for financial products and services. On the other hand, financial sector authorities can leverage the same technologies driving fintech to support their work in ensuring a resilient financial system.

Fintech, however, also poses new challenges to the financial system. Different international organisations have highlighted these issues in their respective papers, and I already gave a concrete example earlier. These challenges include heightened operational risks, particularly cyber-risk, macro-financial risks, and consumer protection and data privacy issues. In addition, fintech's potential to contribute to financial exclusion should also be considered. For example, the use of artificial intelligence and machine learning in underwriting credit and insurance could lead to more accurate pricing and risk assessment, but it may also price some consumers out of the market.[9]

Given these risks, effective regulation is necessary in order to provide a solid foundation for safely exploring the benefits of fintech. For regulation to be effective, it should be appropriate, proportionate and timely.

Appropriate regulation could facilitate the potential of fintech to contribute to the objectives of financial stability, market integrity and consumer protection, as well as financial inclusion. Proportionate regulation could avoid impeding efficiency-improving technological progress, while at the same time still addressing the inherent risks. Timely regulation enables a proactive regulatory regime that addresses issues before they happen.

SSBs' contribution to financial inclusion

This brings me to the role of SSBs in the context of financial inclusion and fintech.

SSBs, as you know, work on different issues – such as the safety and soundness of institutions, the integrity of financial transactions and consumer protection – which all contribute to a well functioning financial system. As such, the work of the SSBs is also quite important for financial inclusion and fintech.

Through their standards, SSBs are helping achieve strong regulatory and supervisory regimes that promote confidence in the financial system. In terms of fintech, SSBs' initiatives to help understand the implications of fintech – and to review, revise or supplement their existing standards, if warranted – are critical to maximising the benefits while managing the risks.

However, we should recognise that the influence of SSBs over financial inclusion and fintech has limits. SSBs cannot address the fundamental and structural causes of financial exclusion. To illustrate this point, the 2017 Global Findex Database[10] paints a profile of the unbanked – they are mostly women, poor, with low educational attainment and unemployed. Gender, poverty, education and employment are clearly not within the realm of the standards that SSBs issue.

Moreover, SSBs' standard-setting processes take time. Also, these processes do not start out from scratch; rather, they identify existing "good practices" at the national level that could be applied across

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[9] Financial Stability Board, *Artificial intelligence and machine learning in financial services – market developments and financial stability implications*, November 2017.

[10] Demirgüç-Kunt et al (2018), op cit.

jurisdictions. This points to the role of national authorities in identifying effective means of regulating fintech that suit their respective context.

The BIS's contribution to financial inclusion

So, what is the role of the BIS in all of this?

The BIS's mission is to serve central banks in their pursuit of monetary and financial stability, and to foster international cooperation in that area. In this regard, the BIS hosts a number of SSBs and provides a platform for central banks and other financial sector authorities to discuss and coordinate on financial system issues, including on financial inclusion.

In addition, through the FSI, the BIS promotes a better understanding of the application of proportionality in the implementation of international standards, as well as an understanding of fintech developments, and in general supports capacity building at financial sector authorities around the world. This conference is a good example of the BIS's and the FSI's endeavours to contribute to the achievement of those objectives.

On financial inclusion, in particular, aside from this conference the BIS has also been providing various platforms for coordination between SSBs and the GPFI.

Concluding remarks

To summarise, financial inclusion is improving and fintech is providing more opportunities for further improvement. However, effective regulation is necessary in exploring these opportunities without impinging on financial stability and other policy objectives.

Having said that, existing regulations may need to be adjusted in order to take into account fintech developments. These adjustments must result in appropriate, proportionate and timely regulations.

Identification of these adjustments starts at the national level, and is complemented by SSBs' work in defining standards that promote national practices with cross-border relevance.

The BIS is contributing to all of these undertakings through its work on financial stability and capacity building and in providing platforms for coordination.

The various sessions at this conference will look in detail at most of the issues I have covered in my remarks. I look forward to the discussions, and I wish this conference every success.

Thank you very much.