Regulation and Supervision of Non-Bank Financial Institutions

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Agenda

• Why is NBFI regulation and supervision important for financial inclusion?
• Potential regulatory and supervisory actions to consider in NFIS
• Challenges and opportunities of NBFI regulation and supervision
• Applications at policy and industry level
• Key technical resources
Why is NBFI regulation and supervision important for financial inclusion?
NBFI regulation and financial inclusion

• In many countries, NBFIs are the primary providers of financial services striving to attend unserved and underserved customers
• NBFIs need regulatory certainty to operate in a fast-changing financial sector
• Proportionate regulation sets basic requirements to ensure that sound NBFIs provide long-term, sustainable, and responsible financial services to the unserved and underserved
• Regulation contributes to greater consumer trust in NBFIs
NBFI supervision and financial inclusion

• Understand NBFIs’ offering of financial services to unserved and underserved
• Monitor NBFI developments of relevance to financial inclusion, eg growth or evolution that warrants greater attention
• Special attention to NBFIs that, while not systemic based on the value of funds they intermediate, may be systemic due to the number and type of customers they serve
• Promote safety and soundness, and good conduct of NBFIs
• Identify and assess consumer risks
• Assess regulatory compliance and take enforcement actions
Importance of applying an I-SIP approach

• I-SIP is a structured framework to identify linkages – synergies and trade-offs – and help authorities be proportional, ie take measures that are most likely to arrive at the desired outcome considering the interrelationship among 4 key regulatory objectives:

- **Inclusion**: Promote access, use, quality and customer wellbeing/impact
- **Stability**: Preserve safety and soundness of individual providers and the system as a whole
- **Integrity**: Prevent criminal exploitation of the financial system
- **Protection**: Prevent harm to users of (formal) finance
Potential regulatory and supervisory actions to consider in NFIS implementation
Basel Committee Guidance on financial inclusion

• Guidance on application of BCPs to financial inclusion, built on:
  • 2015 Range of practice survey on regulation and supervision of inclusive providers
  • 2010 Guidance on application of BCPs to microfinance

• Guidance highlights the importance of looking at BCPs using I-SIP Approach
• Guidance focuses on 19 BCPs, identified as requiring additional guidance for proportionate application to inclusive providers
Application of Basel Core Principles to NBFIs

• Licensing and permissible activities
• Lower minimum initial capital requirement for small NBFIs that engage in narrower and simpler scope of activities – but high enough to ensure sustainability, financial capacity.
• Consider specific financial cooperatives issues (e.g., member commitments, withdrawable member shares in minimum capital)
• Consider specific MFI issues (e.g., governance requirements when there are non-profit and for-profit investors)
• Tiered criteria, commensurate with permitted activities/ risks
• List of registered, licensed and supervised institutions
Application of Basel Core Principles to NBFIs

• Corporate governance
• NBFIs to ensure culture and values are upheld by third parties
• Authorities to understand NBFI governance structures and practices different from banks (eg board members living abroad)
• Supervisors to issue guidance on expectations for sound corporate governance and how NBFIs can do self-assessments

• Capital adequacy requirements
• Specific measures may be adopted for NBFIs (eg CAR on a group or system basis, liquidity deposits in a second-tier entity)
• Higher CAR may be imposed to address weaknesses
Application of Basel Core Principles to NBFIs

• Cooperation and collaboration
  • Formal and informal arrangements to: design rules, delineate responsibilities, minimize regulatory burden, share information

• Supervisory approaches
  • Alternative approaches: collective and auxiliary supervision
  • Use of external auditors

• Supervisory tools
  • Communication of supervisory expectations
  • Clearer instructions and guidance
  • Use of technology
Application of Basel Core Principles to NBFIs

• Operational risk
• Policies and procedures governing selection, training, and oversight of agents (and other third parties) to address risks
• NBFIs’ final responsibility to supervisors and customers for actions of third parties (eg agents)

• AML/CFT
• Proportionate or risk-based approach whereby NBFIs may use simplified CDD measures for lower risk products

• Consumer protection
• NBFIs’ internal controls, IT systems, policies and procedures to ensure consumer protection / conduct risks are well managed
Challenges and opportunities of NBFI regulation and supervision
## Challenges and opportunities

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<tr>
<th>Challenges</th>
<th>Opportunities</th>
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<tr>
<td>Different business models</td>
<td>Collaborative market intelligence</td>
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<td>Wide range of providers</td>
<td>Dialogue with industry</td>
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<td>Different consumer engagements</td>
<td>Customer centricity</td>
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<td>Numerous players</td>
<td>Different supervisory approaches</td>
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<td>Increasing partnerships</td>
<td>Intra- and inter-institutional cooperation</td>
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<td>Limited supervisory capacity</td>
<td>Supervisory technology</td>
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<td>Broader conduct issues</td>
<td>Greater attention to culture and outcomes</td>
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Applications at policy and industry levels
Policy level application: The I-SIP Approach

- Consider and weigh all four I-SIP objectives
- Understand the effects of a policy intervention on six pairs of linkages: Inclusion-Stability, Inclusion-Integrity, Inclusion-Protection, Stability-Integrity, Integrity-Protection, Protection-Stability
- Assess direct effects that a policy intervention has on an I-SIP objective, and the potential synergies and trade-offs between each linkage
Industry-level application: 4 basic regulatory enablers of digital financial inclusion

- Implement regulatory enablers to promote digital financial inclusion
- Enablers to consider the role that NBFIs can play in advancing financial inclusion:
  - Partnering with NEMIs
  - Using agents
  - Using simplified CDD
  - Applying consumer protection to DFS
Key technical resources
Key publications (I)

• Basel Committee on Banking Supervision, *Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion*, September 2016


• Staschen, Stefan, and Patrick Meagher, *Basic Regulatory Enablers for Digital Financial Services*, CGAP, Focus Note No. 109, May 2018

• Basel Committee on Banking Supervision, *Range of practice in the regulation and supervision of institutions relevant to financial inclusion*, January 2015
Key publications (II)

- Cuevas, Carlos, and Juan Buchenau, *Financial Cooperatives: Issues in Regulation, Supervision, and Institutional Strengthening*, 2018
Thank you!
Questions?