MAP TOOLKIT SERIES

4

Performing the MAP Diagnostic: Analysing the regulations, policy and supervision

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TOOLKIT 4: Performing the MAP Diagnostic: Analysing the regulations, policy and supervision

4

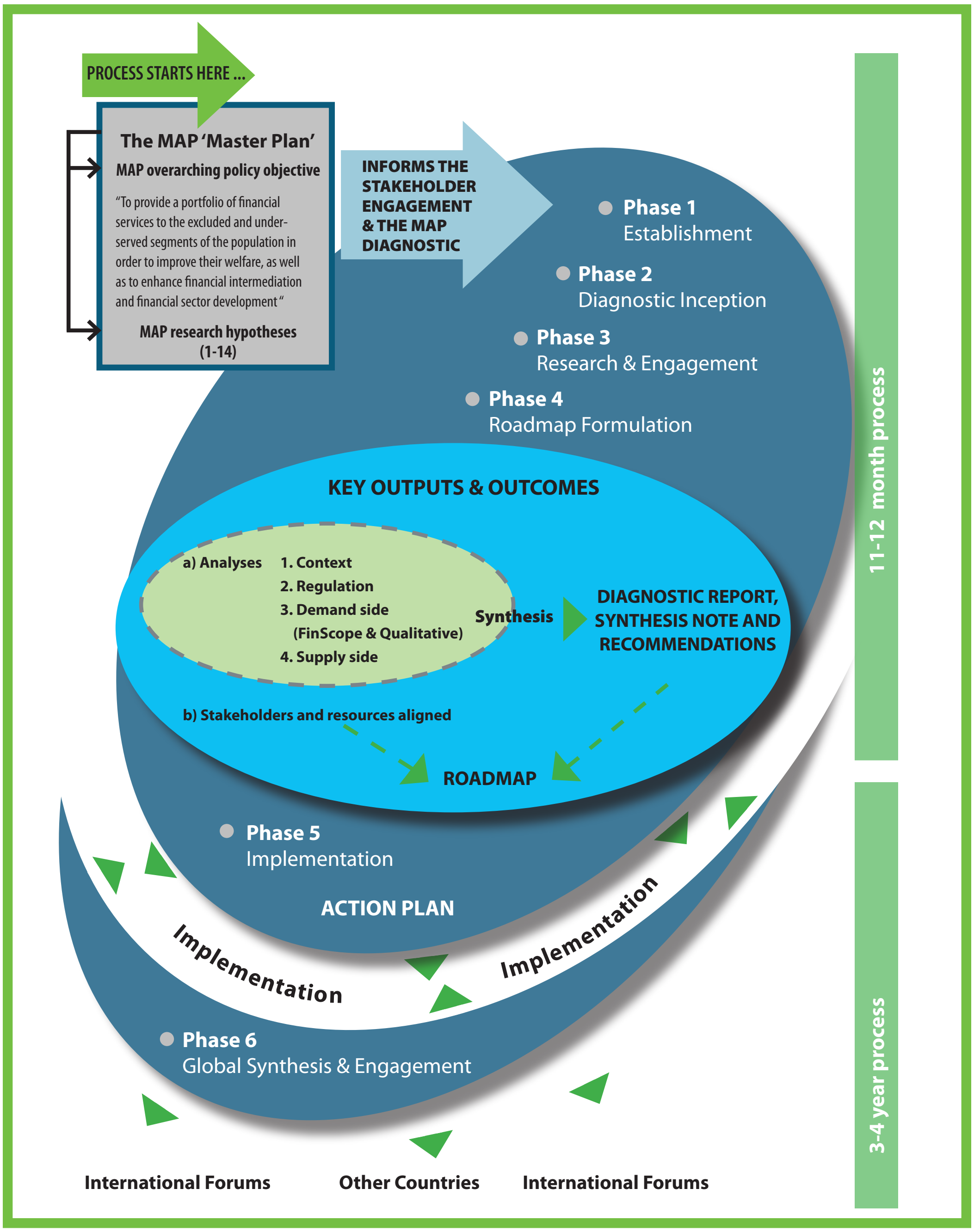
In this Toolkit:

THE MAP PROCESS

CONCEPTUAL OVERVIEW OF THE MAP PROCESS

1. Conceptual overview of the MAP process

The diagram below provides an overview of the MAP process. The focus of **Toolkit 4** is on conducting the regulatory aspect of the diagnostic.



2. Introduction

Toolkit 4 discusses conducting the MAP *regulatory* diagnostic. It considers the policy and regulatory framework as relevant for financial inclusion in the country.

As you are reminded at the start of each of the four toolkits that focus on the main areas of the diagnostic (context, regulation, demand side, and supply side), there is *considerable overlap* between the focus areas. In particular, for example, both regulation (this toolkit) and country context (see **Toolkit 3**) feature very strongly in the supply-side research (**Toolkit 6**), and thus there will be large overlaps with the supply-side data-gathering exercise covered in that toolkit. Similarly, the demand-side findings (**Toolkit 5**) are heavily influenced by both contextual and regulatory issues, and in turn feed into the supply-side research, and so on.

For the other three focus areas of the MAP diagnostic research and analysis, see Toolkits 3 (country context), 5 (demand side) and 6 (supply side). See Toolkit 7 for information on pulling the analyses together into a diagnostic report with recommendations.

3. What are the aims of Toolkit 4?

Working through this toolkit should enable you to:

- Understand what is entailed in researching and analysing the regulatory aspects of a MAP diagnostic;
- Confidently undertake the regulatory diagnostic exercise; and
- Build a dynamic understanding of the regulatory drivers of financial inclusion, analyse your findings and pull together the insights gained to reach relevant conclusions.

Why do we want to do this? By building an understanding of the regulatory framework, the MAP regulatory diagnostic will inform the following of the MAP research hypotheses that, in turn, speak to the overarching policy objective of improving welfare through a portfolio of financial services:

WHY FOCUS ON REGULATION?

INSTRUMENTS THAT SHAPE MARKET DEVELOPMENT

Hypothesis 11

A conducive policy and regulatory environment can accelerate the pace of financial inclusion.

Hypothesis 12

Least-cost regulation requires an understanding of the risks implicit in rendering particular financial services to low-income households.

Policy, regulation and supervision: definition and roles

- ***Policy:*** The term 'policy' denotes the declared intention of a government with regard to how it wishes to order the financial sector and the objectives that it wishes to achieve. The trade-offs between various government objectives (e.g. consumer protection and financial inclusion) are managed within the policy domain. The declared policy of the government may sometimes be sufficient, in itself, to achieve its objectives without the need for specific regulation. In other cases policy has to be implemented through regulation to impact on the market.

- ***Regulation***: Binding legal rules applicable to the financial sector can take various forms. The highest form of rules are statutes or laws passed by the national legislative authority (be it parliament or congress). Legislation is normally difficult and time consuming to adopt and to amend. Laws thus normally provide for the promulgation of subordinate legislation to be issued by the executive authority or financial regulator. Such instruments are more flexible, yet still have the force of law. In some jurisdictions, subordinate legislation is referred to as regulations, but it can also be called directives or rules. In addition, the financial supervisor may issue guidance to interpret legislation or subordinate legislation. Such guidance can be in the form of memoranda or circulars. Such guidance does not have the force of law, but can be converted into legally binding regulations if required.

Remember: By 'conducive policy and regulatory environment' is meant an environment that includes, among other things, least-cost regulation – namely, the minimum compliance burden needed to achieve the regulatory objectives.

4. Why focus on regulation?

The state has a number of instruments available to shape market development. They fall into the three broad categories of ***policy, regulation*** and ***supervision***. Policy, regulation and supervision play a determining role in the development of every financial sector, inter alia because:

- They determine who can enter and operate in the market;
- They have cost implications, through compliance requirements, for providers, which may determine providers' willingness to operate in the low-income market;
- They set registration requirements for clients/consumers that may pose direct access barriers;
- They can compel provision of certain types of products or services; and
- They impact on the development of the payment system, which in turn has implications for all other product markets.

It is no different in the promotion of financial inclusion.

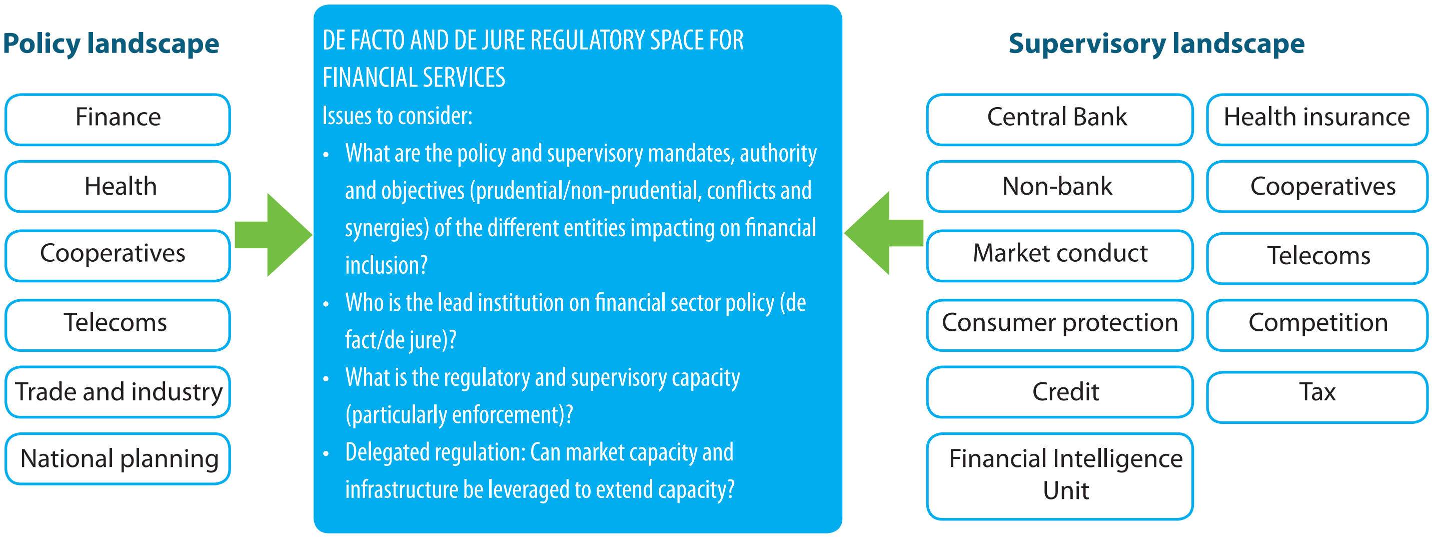
Similarly, the ***absence*** of regulation can create market uncertainty, and thus drive the evolution of the market in a particular direction.

The MAP approach is to unpack the role played by policy, regulation and supervision generally in the promotion of financial inclusion, and also within the context of each financial services market (savings, payments, credit and insurance). The following diagram summarises the interplay within the policy, regulatory and supervisory landscapes for financial services.

SCOPE OF TOOLKIT 4

OVERALL REGULATION FRAMEWORK

Figure 1. Policy, regulatory and supervisory landscapes



Source: Authors' own

Policy, regulation and supervision: definition and roles

- ***Supervision:*** Supervision describes the functions or actions whereby the state seeks to ensure compliance with regulation. The supervisor's role can be defined as the oversight of the implementation of regulation by financial service providers.

Note: Although 'policy', 'regulation' and 'supervision' are separate things, we sometimes refer in the text only to 'regulation' – as a collective term for all three of these. The intended meaning should in each case be clear from the context.

Who performs what role? Generally:

- The ***policymaker*** will be the ministry with jurisdiction over the respective financial services markets;
- The ***regulator*** will be the ministry issuing the legislation pertaining to the specific product market, or a statutory body issuing subsidiary rules; and
- The ***supervisor*** will be a statutory body for implementing such regulation.

For example:

o The banking supervision or payment systems departments in the central bank;

o A credit regulator; or

o An insurance commission or financial services board, superintendence or authority more broadly.

Note: In many jurisdictions the supervisor, as defined here, can therefore simultaneously be the regulator.

5. Scope of Toolkit 4

This toolkit provides the ***overall framework*** within which MAP looks at regulation – while in **Toolkit 6** (on conducting the supply-side diagnostic), the individual product market sections consider the *specific impact* of regulation on the rendering of each financial service in terms of the barriers or constraints represented by regulation to the inclusive function of each of those product markets.

The regulatory research and analysis must:

- Create an understanding of the ***policy environment and the objectives*** of the government with regard to financial sector development in general and financial inclusion in particular – as they currently stand and also as they have evolved over time;
- Describe the ***regulatory scheme*** for the financial sector. The regulatory scheme is the body of legislation and subordinate legislation that collectively governs the provision of financial services;
- Create an understanding of the ***supervisory institutions and processes*** being applied, and the skills and capacity of the financial sector supervisors; and
- Identify the most important ***regulatory initiatives to promote access to financial services***, and the impact of these.

TIP: **Each part of the financial sector is impacted in some way by regulation or, conversely, can give rise to regulatory implications. It will be important to ask what the key areas of regulation are that will be relevant, as well as what the core regulatory questions are to be answered, in order to understand the regulatory implications. This will help to focus the regulatory analysis on those aspects that are directly relevant to the MAP outcome.**

SCOPE OF TOOLKIT 4

OVERALL REGULATION FRAMEWORK

Related links

Proportionality is one of the nine principles for innovative financial inclusion adopted by the G20 Global Partnership for Financial Inclusion (ATISG 2010). Principle 8: Proportionality reads: 'Build a policy and regulatory framework that is proportionate with the risks involved in such innovative products and services, and is based on an understanding of the gaps and barriers in existing regulation'. See: **www.gpfi.org/sites/default/files/documents/G20%20Principles%20for%20Innovative%20Financial%20Inclusion%20-%20AFI%20brochure.pdf**

Something to think about

The regulatory findings will make up a comparatively short section of the diagnostic report – particularly given that regulation crops up in different guises in relation to the other three diagnostic focus areas.

At this point, it makes sense to take a look at Diagnostic Resource E: Applying issue tree logic. That resource explains the analytical logic applied in conducting the MAP diagnostic. Applying the issue tree logic will assist in setting the parameters or key areas of analysis for the MAP regulatory diagnostic exercise.

Diagnostic do's and don'ts: regulatory issues to be on the lookout for

In sketching the policy, regulatory and supervisory landscape, the diagnostic should go beyond a mere listing of authorities and mandates to unearth any relevant undercurrents.

For example:

- **Policymaker role**: It may be that there is a 'missing policymaker' in that the Ministry of Finance fulfils largely a treasury function and does not play an active role in shaping financial sector policy. If this is the case, does anybody else 'step up' to fulfil that role? Who, and how?
- **Intra-government coordination:** It may also be that there is a fragmented and uncoordinated policy environment, with multiple pieces of legislation and several different supervisory authorities from different line ministries impacting on inclusion. If this is the case, how does it shape financial inclusion outcomes? How does the interplay between various authorities work in practice? How can coordination be improved to support financial inclusion?
- **Balancing act:** Where the market analysis reveals high levels of informality (*see also the discussion in* Toolkit 6 *of the informal market*), it will place particular demands on supervisory capacity. Developing- country supervisors face substantial challenges in managing formalisation and enforcement with limited supervisory capacity. Extending financial inclusion may result in a larger number and variety of financial players involved in the value chain (particularly non-traditional and non-financial players), which may require different degrees of regulation. Careful consideration would need to be given to finding efficient supervisory models that do not unnecessarily constrain development. Indeed, balancing consumer protection with market development is likely to emerge as one of the central challenges in general as markets evolve.
- **Proportionality:** International standards across product markets are moving towards a risk-based or proportionate approach, whereby the level of compliance can be calibrated to the level of risk posed. This means that supervisory authorities can tailor compliance with international standards in a way that suits domestic priorities and the level of development in the particular country. In practice, there are many challenges in implementing such a risk-based or proportionate approach, and it will be important to understand what the stance is in this regard in the particular country.

6. Getting going on researching and analysing the policy environment

The policy environment is integrally linked to the overall political economy (*see* **Toolkit 3,** *on the country context diagnostic, for more about the political economy*). At the outset, it is vital to understand the dynamics of the country and the overall macro-objectives, as this is important in providing the overall context. At a more granular level, the policy analysis must link the overall financial sector policy environment to financial inclusion.

See also **Diagnostic Resource B: Illustrative interview questions** – the section 'Questions for policymakers, regulators and supervisors'.

RATIONALE	This section of the regulatory diagnostic seeks to understand what the policy elements are that will shape financial sector development. It is important to understand current policies, as well as incipient or potential future policy changes.
Aspects to cover	• Various government policies will influence financial inclusion. These can include the following: • General financial sector policy (e.g. a priority focus on stability rather than access); • Specific financial inclusion policies; • Health policy as it relates to health financing and the use of insurance to finance health expenditure; • Cooperatives policy – particularly the extent to which cooperatives are allowed to render financial services; • Telecommunications policy, both as a communications medium and a potential platform for rendering financial services; • Trade and industry policy (for specific policies that relate to trade and SME development); and • Immigration policies, which will impact on remittance markets.

See also **Diagnostic Resource B: Illustrative interview questions** – the section 'Questions for policymakers, regulators and supervisors'.

7. Getting going on researching and analysing the overall regulatory scheme

Each financial sector has its own regulatory scheme. This is the combination of laws and regulations that govern the establishment and operation of financial sector supervisors as well as the licensing, registration and conduct of financial services providers and intermediaries. Understanding the scheme enables quick location of the rules pertaining to particular players and markets. Sometimes one law can cover multiple financial services markets; sometimes each financial services market has its own law.

RATIONALE	This section of the regulatory diagnostic seeks to outline the applicable financial sector regulatory scheme in the country, noting differences for particular product markets where applicable. This lays the foundation for analysing material provisions leading to issues with regard to or constraints on financial inclusion in each of the product market analyses (*see* Toolkit 6 *for more on the product markets*)
Aspects to cover	The following parameters should be covered as part of the regulatory scheme: • **Establishment of financial regulators and supervisors:** including central banks, non-bank financial supervisors, microfinance regulators etc. • **Institutional regulation**, being the statutory requirements that determine the legal forms or persons – e.g. public companies and cooperatives – that may provide various types of financial services, as well as the corporate governance requirements applicable to these legal forms and the reporting requirements that they must meet. The content of institutional and corporate governance regulation is generally not specific to any one product market, but generic across sectors. Examples include: Companies Act, Friendly Societies Act, Cooperatives Act, and governance codes (if applicable). • **Prudential regulation** governing the entry and continued operations of financial services providers, including minimum levels of capital, solvency margins, reporting requirements and capital ratios. • **Market conduct regulation,** which regulates the intermediation of financial services. Regulation of this kind could include: o Requirements as to who can intermediate, under what conditions and meeting which requirements; o Regulation of the sales or customer registration process, including disclosure requirements and advice; and o Regulation of the level and structure of commissions paid.

Aspects to cover	Other market conduct requirements may relate to how institutions treat customers, under what conditions products may be cancelled, when credit may be issued, when security may be claimed on loans and what recourse mechanisms should be available to customers. • **Product regulation** can be distinguished from prudential and market conduct regulation in that it does not relate primarily to the institution's prudential situation or its market conduct, but to the design and content of the products or services that it provides. These may include price controls, minimum terms and conditions, a prohibition on exclusions in the case of insurance products, collateral requirements in the case of credit, and so on. • **Consumer protection and recourse:** There may be other consumer protection and recourse mechanisms not covered in prudential, market conduct or product regulation. This may include provision for an ombudsman or industry tribunal, or an entirely non-financial sector-specific consumer protection regime. • **Other regulation**: This entails other non-financial sector regulatory requirements that affect the provision of financial services to previously excluded or underserved clients. Examples include: o Anti-money laundering or combating the financing of terrorism (AML/CFT) provisions (which may insist on an overly onerous requirement on identification of clients that may not have adequate documentation); o Taxation; o Labour regulation; o Privacy laws; o Land title and ownership regulation; o Bankruptcy and liquidation regulation; o Telecommunications regulation; o Health regulation (relevant in the case of insurance); o Competition regulation; o SME regulation; and o Transformation regulation where applicable.

TIP: It is important not to 'boil the ocean' in analysing in detail each piece of legislation that may in some way be relevant to financial services provision. Rather, focus on the material provisions impacting most strongly on financial inclusion.

Similarly, often financial services providers are governed not only by a financial sector law (such as a banking or credit institutions law) but also by a companies or cooperatives law that regulates the operation of the institution rather than the financial service it performs.

In addition to financial sector-specific laws and institutional laws that govern the legal personalities of financial services providers, other laws – notably tax legislation – can impact on the provision of financial services.

GETTING GOING

OVERALL INSITUTIONAL STRUCTURES

Related links

The tips in this box draw directly on the toolkit for insurance diagnostic studies developed by Cenfri for the Access to Insurance Initiative (A2ii 2010). The dedicated toolkit is available at: **www.a2ii.org/knowledge-centre/tools-and-guidance/a2ii-toolkits.html**

Diagnostic do's and don'ts: tips for gathering regulatory information

Focusing the analysis: In embarking on the research, remember that aspects of regulation should only be analysed insofar as they are relevant to answering the MAP research hypotheses.

Useful sources: In addition to the conventional sources of regulatory information, the following may prove useful:

- Consulting the compliance officers of financial institutions;
- The complaints logs of consumer protection agencies; and
- Financial sector assessment program (FSAP) reports conducted by the World Bank/ IMF.

Other tips: For many countries, primary legislation or regulations may not be available in English. It is important early on to assess the availability of legal instruments in English and to ensure that the most critical pieces are translated into English prior to the country visit. Include an interview with a local lawyer working in the financial sector. Such a person is likely to have a very practical knowledge of the national regulatory framework and where the main obstacles are.

See also **Diagnostic Resource B: Illustrative interview questions** – the section 'Questions for policymakers, regulators and supervisors'.

8. Getting going on researching and analysing the supervisory landscape

The overall institutional structures that exist to implement policy and regulatory objectives are important. Thus, in analysing the policy and regulatory sector for the diagnostic, it is important to unpack the existing institutional structures and their ability to implement policy and regulation.

RATIONALE	For it to take effect, regulation needs to be *implemented*. For this reason, the following are key drivers of the impact of regulation: • The mandate, authority and objectives of the respective supervisory authorities in the financial services sphere; • Inter-jurisdictional interaction and coordination; and • The level of supervisory capacity to implement and enforce regulation.

Aspects to cover	• The **relevant authorities**, including the central bank, the non-bank financial institutions regulator, the financial intelligence unit and, where applicable, dedicated regulators for financial sector market conduct, consumer protection, credit or insurance. Regulatory authorities of ancillary regulatory spheres will also be relevant, including the medical schemes regulator, the cooperatives regulator, the telecommunications regulator, competition authorities and tax authorities; • The extent to which there is **coordination** between jurisdictions on cross-cutting topics, and whether any inter-jurisdictional committees or forums exist; • The **core mandate and objectives** of each main authority, and the extent to which these allow for or actively promote financial inclusion; and • **Supervisory capacity:** in terms of staff numbers and types, as well as systems (including offsite and onsite reporting systems, supervisory manuals and management information systems for analysis of data). When assessing supervisory capacity, also consider whether there are aspects of delegated regulation or supervision whereby market capacity/infrastructure is (or can in future be) leveraged to extend supervisory capacity. It will be important to assess the existing practices and future capacity of supervisors to assess the risks inherent in delivering financial services.

9. Assessing public initiatives to improve access to financial services

In addition to unpacking the financial sector policy, regulatory and supervisory landscape, the MAP diagnostic includes a dedicated analysis of policy and regulatory initiatives for financial inclusion, or fiscal measures or direct state interventions to extend financial inclusion.

RATIONALE	With a view to being in a position to offer future advice and formulate strategy, MAP must describe and assess the impact of current and previous public initiatives to improve access to financial services.

INTERVIEWS AND CONCLUSION

Aspects to cover	Such initiatives can take various forms, including the following: • A broad-based financial inclusion policy; • A concessionary regulatory framework for the provision of microcredit or microinsurance, or to allow for branchless banking and e-money initiatives with a view to promoting financial inclusion; • The public provision of subsidised financial services through state-owned or privately owned service providers; • Compulsory or consensual quotas targeting defined population segments; • Financial literacy initiatives; • Tax incentives; and • Measures to extend the reach of the formal payment system.

Note: It will be important to gather as much information as possible to enable assessment of the impact of the various initiatives.

See also **Diagnostic Resource A: Institutions to consult**, for suggestions on identifying institutions and stakeholders to consult, making the most of your time in-country, and scheduling meetings efficiently for maximum effect. Note that you will need to judge which of the indicative institutions listed in Diagnostic Resource A should be on your list of those to consult.

See **Diagnostic Resource B: Illustrative interview questions**, the section 'Questions for policymakers, regulators and supervisors'.

10. Getting the most out of regulatory interviews

One of the primary means of collecting up-to-date policy, regulatory and supervisory information is through meetings with institutions – including of course policymakers, regulators and supervisors, but also others. Such meetings are vital in making sense of the policy and regulatory landscapes, obtaining key pieces of legislation, understanding regulatory barriers and challenges, and grasping the impact of capacity constraints.

Once meetings are scheduled, you will need to focus on the tactics of the meeting.

Given that the questions to ask will vary depending on the regulatory authority consulted, the list of questions provided in Diagnostic Resource B is indicative only.

TIP: As Diagnostic Resource B suggests, in addition to covering such questions during the interview, you should use the interview to obtain access to aggregated industry data as contained in supervisory annual reports and datasets (if not already available online). This can include data regarding the number of players, outlets and distributors, as well as financial performance indicators of players.

11. Conclusion

This toolkit has focused on one of the four key areas of the MAP diagnostic, namely the area of regulation, policy and supervision.

The aim has been to help you build a dynamic understanding of the importance of regulation in every financial sector, as well as emphasising how the absence of regulation can create market uncertainty and thus also drive the evolution of the market in a particular direction. The point has been made that each part of the financial sector is impacted on in some way by regulation or, conversely, can give rise to regulatory implications, and thus there will be considerable overlap between regulation and the other MAP diagnostic focus areas.

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