

ENABLING POLICY AND REGULATION FOR DIGITAL FINANCE ECOSYSTEMS: A Theory of Change

How UNCDF supports governments to navigate the digital revolution

MAY 2018

WE HELP GOVERNMENTS BUILD INCLUSIVE FINANCIAL MARKETS

We at the UN Capital Development Fund (UNCDF) have been working with national governments to improve access to financial services for over 25 years. In the last decade, we have focused specifically on the role that digital technologies play in accelerating usage of financial services by low-income people. In over 40 markets, we have worked with policymakers and regulators, which have proven to be natural partners, on the common goal of using technology to build inclusive markets for sustainable economic development.

The role of UNCDF as a neutral broker underpins our capacity to contribute to market development.¹ We believe if the right stakeholders

are supported with expertise and capital, then appropriate products and services can reach customers, who will use them to improve the quality of their lives and to reduce their financial vulnerability. Policymakers and regulators are the stakeholders that directly influence market dynamics in the financial services sector. As a neutral broker with in-country presence and experience working with the private sector, including financial service providers, we are uniquely positioned to facilitate government engagement with the financial industry to provide legal clarity, reduce business obstacles, and protect customers within a widely endorsed roadmap in which public policy and market objectives align.

WE SEEK IMPACT ACROSS A BROAD RANGE OF SERVICES THROUGH DIGITAL SOLUTIONS

As a UN agency, our mission at UNCDF is to create conditions that reduce the impact of external shocks on the lives of poor and vulnerable people. Achievement of the Sustainable Development Goals (SDGs), such as improved health outcomes, quality education, clean water and sanitation, or affordable and clean energy, can dramatically improve people's lives. Numerous governments with which we work have formally endorsed the intended outcomes of the SDGs, many in explicit terms. Their public policy objectives therefore often align with the intent of the SDGs, creating a natural narrative for collaboration between UNCDF and government partners.

New technological solutions and digital services can reach many more people compared to traditional means. Moreover, appropriate digital financial services (DFS) are seen as contributing to 12 of the 17 SDGs. In most cases, such services require partnerships among market actors to achieve multiple development outcomes. Hence, we at UNCDF see SDG 1 (No Poverty) as our desired impact and SDG 17 (Partnerships) as our means of achieving that impact (see figure I). This approach helps us work with policymakers and regulators to ensure that an enabling environment delivers real value to people and can drive the impact we seek.

Figure I
Approach of UNCDF to Sustainable Development Goals



¹ See <http://www.uncdf.org/mm4p/home> for more information.

THE PACE OF CHANGE REQUIRES SYSTEMATIC POLICY SUPPORT

As technology and information rapidly force the evolution of global and local markets, we must act quickly to support policymakers and regulators to adapt to a swiftly advancing future full of opportunity and uncertainty.

An interconnected digital economy requires an agile, well-informed approach to risk management. For example, as new and old customers use digital channels from multiple and diverse providers, protecting customer data has become a policy focus area. Complementarily, as more people use formal financial accounts and expect their money to be accessible on demand, protecting funds will continue to be a priority issue.² Increasing customer trust will also be emphasized, as rapid economic development will be driven by it.³ In a competitive environment that evolves quickly, engendering customer trust is a constant process, and governments represent one of the few actors at the national level to which customers can look for protection from abuse and endorsement of reliable systems.

Super-platforms such as Alibaba, Alipay, Facebook, Google and Tencent,⁴ among others, exemplify the new types of market players with which governments will soon contend.⁵ These global entities will require focused attention of regulators, whether they are ready or not.⁶ They will (by definition) cut across multiple areas of the market, overlapping many regulatory jurisdictions. They will challenge existing licensing and regulatory regimes and put pressure on infrastructure and oversight, simply because of the sheer volume of transactions these platforms process, regardless of the service. Regulators will have to seek solutions to ensure a level playing field, leveraging the network effect of these platforms and their high-volume capacity, while allowing smaller, local innovations to flourish.



PRIMARY INSTRUMENTS: TECHNICAL ASSISTANCE AND FINANCIAL SUPPORT

We understand the case for change, and we leverage our local and global presence to provide government counterparts the support they need through technical and financial assistance. Technical assistance, in the forms of information access and expertise, can inform appropriate policy decisions in their respective markets. Financial assistance can help governments to act on market information, facilitate dialogue with stakeholders and experiment with new approaches.

Expertise and capital are effective means of support if they can address specific aspects of the challenges facing policymakers and regulators. Engaging regulators in this way requires a constant local presence of staff

who deeply understand local market dynamics and can provide support for the duration of time required to bring about market change—a process that can take years. Our local teams have gained the trust of regulators and private-sector actors alike by demonstrating that they are willing to stay the course to support positive change. We at UNCDF believe that addressing systemic issues as specifically as possible is the pathway to contribute to sustainable policy change. We have taken this approach and built our policy and regulatory engagement strategy around it.

FOUR ACTIVITIES THAT ACCELERATE THE ENABLING ENVIRONMENT

There are four categories of activities that we believe can address the needs of policymakers and regulators while improving the enabling environment for digital solutions: (i) **Expert guided policy development**, (ii) **Data driven decision-making**, (iii) **Constructive public-private dialogue** and (iv) **Exposure to global practice**. Each of these activities is defined below and illustrated with examples from the field:



EXPERT GUIDED POLICY DEVELOPMENT

'Expert guided policy development' requires careful consideration of policy options, their potential market impact and their alignment with industry incentives. In Liberia, we consulted on agent banking guidelines, in light of global best practices, which resulted in regulations that have enabled greater service outreach. In Nepal, we advised the central bank on the development of a payment service provider licence, which led to the licensing of the main remittance provider to facilitate cross-border electronic remittances. In Zambia, we supported the central bank and the Office of the UN High Commissioner for Refugees (UNHCR) to negotiate changes to the country's anti-money-laundering provisions, which helped refugees use UNHCR identification to access digital accounts.



DATA DRIVEN DECISION-MAKING

'Data driven decision-making' implies systematic collection and assessment of market data (both supply and demand) in order to inform regulation and guide policy priorities. We worked with MIX Market to create dashboards for regulators in Benin, Senegal and Zambia to understand their local landscapes.⁷ In Nepal, we partnered with the central bank to build a fully automated geospatial mapping system to locate financial infrastructure, in response to the 2015 earthquake.⁸ In the Pacific Islands, our teams have worked with regulators on a multinational demand-side study to understand the real impact of inclusive financial policies.⁹

² David Medine, 'Making the Case for Privacy for the Poor,' 15 November 2016. Available from <http://www.cgap.org/blog/making-case-privacy-poor>

³ Mike Sturm, 'Rachel Botsman: An Economy of Trust,' 4 February 2018. Available from <https://www.nbforum.com/nbreport/rachel-botsman-economy-trust/>

⁴ Mention of any firm or licensed process in this article does not imply endorsement by the United Nations.

⁵ Examples include the WeChat Wallet in Africa (see <https://www.standardbank.com/standardbank/Personal/Self-service-banking/Innovative-Payment-Solutions/WeChat-Wallet>) and PayMaya and Gcash in the Philippines (see <https://newsroom.fb.com/news/h/an-easy-way-for-people-in-the-philippines-to-access-their-money-on-messenger/>).

⁶ David Porteous and Olga Morawczynski, 'The Superplatforms are Coming ... And They Will Transform Financial Inclusion,' 22 January 2018. Available from <https://nextbillion.net/the-superplatforms-are-coming-and-they-will-transform-financial-inclusion>

⁷ See <http://finclusionlab.org/> for examples of interactive dashboards.

⁸ Nepal Rastra Bank, 'Financial Inclusion Map,' Available from https://dev.nrb.org.np/analytical/map/usage_deposit (accessed May 2018).

⁹ Daryl Collins and Amolo Ng'weno, 'Do Financial Inclusion Efforts Really Have an Impact on Poverty?,' 29 January 2018. Available from https://ssir.org/articles/entry/do_financial_inclusion_efforts_really_have_an_impact_on_poverty

FOUR ACTIVITIES THAT ACCELERATE THE ENABLING ENVIRONMENT (cont.)



CONSTRUCTIVE PUBLIC-PRIVATE DIALOGUE

'Constructive public-private dialogue' is enabled by regular engagement of public and private stakeholders to discuss specific market constraints and public policy objectives. This effort also includes dialogue among regulators, to clarify jurisdictions, share data and rally behind a common economic vision. In Zambia, we brokered a solution to raise digital wallet limits so that service providers could offer mobile money to merchants. In Malawi, we convened a working group to regularly meet and discuss how banks and mobile network operators could own the national switch. And during the Ebola crisis in Sierra Leone, we helped the regulator create the legal space for a mobile payment solution that helped health workers tend to the sick without worrying about their next payment.



EXPOSURE TO GLOBAL PRACTICE

'Exposure to global practice' allows local regulators to understand their choices in the context of emerging trends and how these can be applied (or avoided) in their domestic markets. The One Household One Account policy in Myanmar was developed based on a discussion of lessons from global peers, such as India and South Africa. The Better Than Cash Alliance supported Benin and Senegal to design their government-to-people programmes based on an exchange visit to Colombia. We work closely with the Alliance for Financial Inclusion, CGAP, GSMA and other global partners to ensure that our government counterparts leverage the growing knowledge base and experience in scaling digital finance.

WE FOCUS ON CLEAR OUTCOMES THAT COLLECTIVELY CONTRIBUTE TO CHANGE

The activities in the four categories together affect specific government stakeholder outcomes that can then influence improvements to the enabling environment for DFS. Using data well to make policy and regulatory decisions can directly improve capacity to monitor and supervise the market. In turn, there is more space for innovation and new market entrants as well as risk-based policymaking. This synergistic approach is seen in Bangladesh, Nepal and Zambia, where our teams are helping regulators improve their analytical capacity and market monitoring.

Constructive public-private dialogue enables better collaboration among sectors and helps align public and private objectives. This cooperation allows for difficult and complex issues to be dealt with systematically and in a coordinated fashion. For instance, retail payment interoperability in Myanmar, refugee integration in Uganda and the effect of inflation on wallet limits in Zambia are all complex issues that require careful policy and regulatory responses.

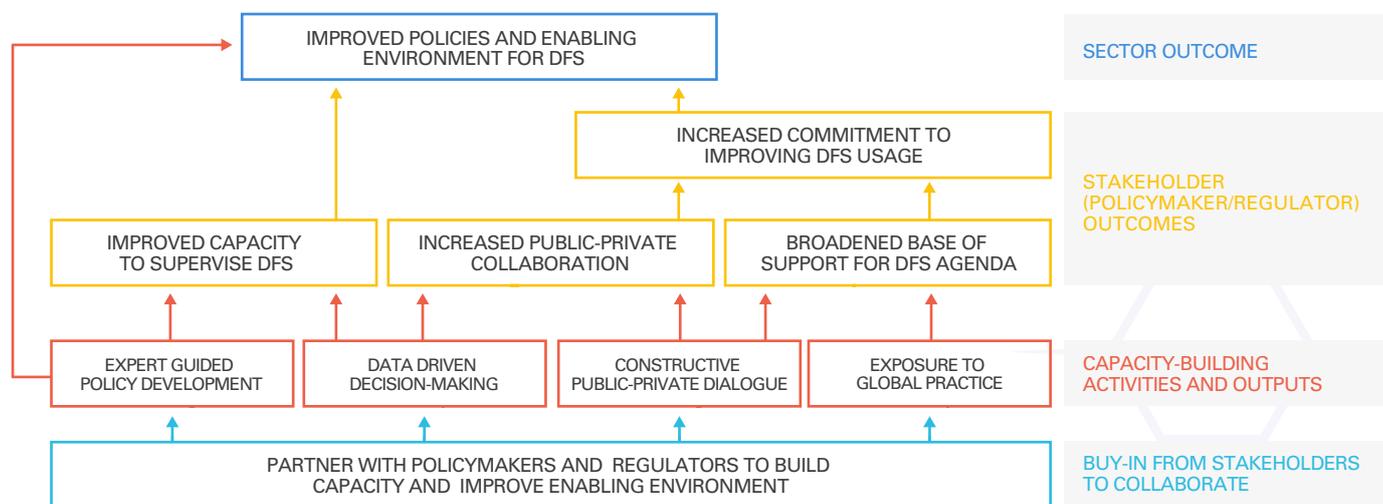
Constructive public-private dialogue and exposure to relevant global practices together set the stage to develop a broad base of support for a digital finance agenda. Transparent engagement with local and

global peers and learning from emerging models help citizens and local media to understand how their government seeks to address domestic challenges. For example, developing a regulatory sandbox in Sierra Leone showed the Government's willingness to encourage innovation,¹⁰ while promoting cross-border interoperability in Uganda helped the central bank demonstrate how people can send money to their regional neighbours.

It is critical to recognize that a broad base of support from citizens and media, along with private-sector collaboration, can collectively increase government commitment to the process of improving DFS usage.¹¹ Public statements of commitment to financial inclusion by members of the Alliance for Financial Inclusion have helped to drive this kind of local dialogue and peer support.¹²

These systematic improvements in the legal and regulatory environment (see stakeholder outcomes in figure II) can promote local innovation, increase competition, as well as drive infrastructure investment and other market reforms that together encourage customers to trust and use formal financial services.

Figure II
Intended outcomes of UNCDF activities



¹⁰ Ghiyazuddin Ali Mohammad, 'Five trailblazing DFS and FinTech regulatory trends not to miss in 2018,' 10 January 2018. Available from <https://www.afi-global.org/blog/2018/01/five-trailblazing-dfs-and-fintech-regulatory-trends-not-miss-2018>

¹¹ Akinkunmi Akingbade, 'Here are 5 of Africa's most financially inclusive countries,' 19 August 2016. Available from <http://venturesafrika.com/here-are-5-of-africas-most-financially-inclusive-countries/>

¹² Alliance for Financial Inclusion, 'Maya Declaration.' Available from <https://www.afi-global.org/maya-declaration> (accessed May 2018).

WE ADAPT TO THE MARKETS IN WHICH WE WORK TO FIND SOLUTIONS THAT ARE EFFECTIVE AND SUSTAINABLE

When entering a market, we at UNCDF understand that solutions must be developed locally to be sustainable. Our approach to market engagement always starts with establishing buy-in from important actors, particularly governments. Once we have buy-in and demonstrate our understanding of the local and global context, our value and our capacity to facilitate market change, we are well positioned to start helping to improve the enabling environment for DFS. At this stage, the relationship established with policymakers and regulators is ready for the active pursuit of new approaches and innovations to enable DFS to reach scale.

Even with this systematic approach to working with local actors, we acknowledge that all markets are unique. The activities and outcomes discussed will be effective in different forms and combinations based

on the respective market needs. However, from our broad experience, we believe that taken together they can contribute to improving the legal and enabling environment for retail financial services. And, they are necessary to keep pace with the digital revolution cascading across the world.

We at UNCDF are proud of our work with national governments, policymakers and regulators on this journey. We are committed to continuing our support in order to assist these stakeholders in the development of policies that can alleviate poverty and bring real value to people's lives. We have high expectations of our counterparts at all levels of government, and they hold us to the same rigorous standard.¹³ We look forward to continued partnership.

¹³ Ahmed Dermish, 'Digital Finance 10 years from now: What we expect from policymakers,' 26 January 2018 Available from <http://www.uncdf.org/article/3210/digital-finance-10-years-from-now-what-we-expect-from-policymakers>

ABOUT MM4P

The MM4P programme launched in 2012 because UNCDF saw that the gains in digital finance were not reaching the least developed countries. MM4P was created to demonstrate how the correct mix of financial, technical and policy support can build a robust digital-finance ecosystem that reaches low-income people in the least developed countries. In doing so, it has helped accelerate growth in several countries, identified some of the levers to help markets develop and supported efforts to reach the last mile.

ABOUT UNCDF

UNCDF is the UN capital investment agency for the world's 47 least developed countries. With its capital mandate and instruments, UNCDF offers "last mile" finance models that unlock public and private resources, especially at the domestic level, to reduce poverty and support local economic development. UNCDF financing models work through two channels: financial inclusion that expands the opportunities for individuals, households, and small businesses to participate in the local economy, providing them with the tools they need to climb out of poverty and manage their financial lives; and by showing how localized investments—through fiscal decentralization, innovative municipal finance, and structured project finance—can drive public and private funding that underpins local economic expansion and sustainable development. By strengthening how finance works for poor people at the household, small enterprise, and local infrastructure levels, UNCDF contributes to SDG 1 on eradicating poverty and SDG 17 on the means of implementation. By identifying those market segments where innovative financing models can have transformational impact in helping to reach the last mile and address exclusion and inequalities of access, UNCDF contributes to a number of different SDGs.

FOR MORE INFORMATION

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