The Fintech Revolution: Promising, but Not a Free Lunch

The World Bank/IMF Annual Meetings in mid-October in Bali marked the launch of the Bali Fintech Agenda, a set of 12 policy elements aimed at better harnessing the benefits and opportunities of rapid advances in financial technology, while seeking to manage the attendant risks. The Agenda, which is detailed in the Annex below, sets out a broad roadmap, to be used by national authorities as a refence point for policy design and implementation. During the Annual Meetings, I also had the privilege of speaking at two seminars organized by the Financial Services Authority of Indonesia (OJK). They centered around Fintech's, and the digital revolution's, positive and inclusive sustainable development promise as well as risks.

The innovations spurred by digital technology breakthroughs are starting to revolutionize the availability of financial services, which is sorely needed, with 1.7 billion people world-wide currently unbanked. The reach of the formal banking services has been constrained by the cost of physically reaching people in rural and geographically remote areas, as well as the economics of servicing low-income populations and small- and medium-sized enterprises. In this regard, Fintech has the potential to broaden the reach of formal financial services, sharply lower costs and spur economy-wide efficiency gains. The resulting income and employment gains and poverty reduction should help bring more inclusive, sustainable and strong growth.

The digital drivers of the fintech revolution are multifaceted. The private sector-led development of telecom infrastructure and falling costs are exponentially increasing the availability and use of smart phones and other mobile devices as well as broadband internet services. Advances in cryptography and biometric identification are also powerful drivers, as are distributed computing and big data/artificial intelligence/machine learning.

The promise of Fintech is epitomized in the wave of innovation in payments, clearing and settlement, offering both banked and unbanked consumers cheaper and faster services, which has also powered the expansion of e-commerce. Fintech service providers are now beginning to offer saving, borrowing, insurance and other financial products, credit-scoring using behavioral analysis, risk management and diverse advisory services. As a result, financial inclusion, which brings access to useful and affordable financial products and services, can fundamentally reshape the lives of people across the world and have a hugely positive economic and social impact. Another positive spillover comes from governments benefitting from reduced leakages and better targeting of public services, while an expanding tax base through improved compliance allows greater resource-generation for public investment.

Starting in Africa, with the telecom-led mobile financial services firm, M-Pesa, Asia is now increasingly the hub of global digital innovation and expansion, with billions of dollars of investments in search of the next unicorn. China is the leading player, and increasingly a source of investments, while progress in other countries is also rapid. Some examples of successful Fintech innovators in Asia are Ant Financial, ZhongAn, Paytm and Go-Jek. Ant Financial, a leader in payments with Alipay, branched out into wealth management, credit scoring, private banking and cloud computing. ZhongAn is utilizing big data for its digitized property insurance operations, a joint venture between Alibaba, Tencent and Ping An insurance. Paytm is an Indian e-commerce payments and digital wallet firm, also backed by the Alibaba Group, while GO-JEK a leading unicorn in Indonesia has diversified from ride-hailing services to payments and e-wallets.

The promise of Fintech is wide-ranging, but there are risks. Fintech tends to be so far lightly regulated or even unregulated in some jurisdictions, and soundness and stability are concerns, as evident from the recent problems prompting a regulatory crackdown in China. Payments and e-money operators also use essentially private money, which carries credit and settlement risks. Broader financial stability questions arise as fintech expands from a low base and linkages with banks grow. There are concerns associated with data privacy, data security and anti-money laundering (AML)/combating financing of terrorism (CFT) compliance. Competition concerns stem from concentration of e-commerce platforms and closed payments networks. Managing cybersecurity risks is increasing important. Cryptocurrencies raise issues related to excessive price volatility, lack of investor/consumer protection, illicit activities, and possible regulatory arbitrage and contagion. Other Fintech risks relate to monetary policy transmission, financial safety nets, lender-of-last resort, and questions regarding crisis management and resolution.

The risks call for an appropriate supervisory and regulatory approach at the country level, backed by international cooperation to address cross-border concerns. Policy needs to strike the right balance between not stifling innovation while guarding against financial stability risks. Regulatory sandboxes, incubators and accelerators can be used to test new products and technologies. Bringing fintech under strengthened, effective and unified supervisory oversight is a priority. In this regard, regulation/licensing/risk management should be based on activity rather than type of institution, to arrive at a level playing field for financial service providers. Appropriate rules and standards also need to be set for data protection, privacy and technology, along with cybersecurity protection and reporting standards.

The promise and the concerns are set out in the Bali Fintech Agenda, which strikes the right balance and provides a useful framework for policymakers. The Bali Agenda also rightly sees a role for central banks to issue digital currency, and expanding access to and improving the resilience of payments services. The issue of digital fiat currencies by central banks would help preserve their control and relevance as well as trust, interoperability, openness and security of payments and settlements systems, besides addressing concentration and competition concerns. Moreover, such a token-based digital fiat currency would persevere the current two-tier financial system of commercial and central banks, while limiting monetary policy transmission and financial stability consequences.

ANNEX

The Bali Fintech Agenda: A Blueprint for Successfully Harnessing Fintech's Opportunities

I. Embrace the Promise of Fintech with its far-reaching social and economic impact, particularly in low-income countries, small states, and for the underserved, and prepare to capture its possible wide-ranging benefits, including: increasing access to financial services and financial inclusion; deepening financial markets; and improving cross-border payments and remittance transfer systems. Reaping these benefits requires preparation, strengthening of institutional capacity, expanding outreach to stakeholders, and adopting a cross-agency approach involving relevant ministries and agencies.

II. Enable New Technologies to Enhance Financial Service Provision by facilitating foundational infrastructures, fostering their open and affordable access, and ensuring a conducive policy environment. Foundational infrastructures include telecommunications, along with digital and financial infrastructures (such as broadband internet, mobile data services, data repositories, and payment and settlement services). The infrastructures should enable efficient data collection, processing, and transmission, which are central in fintech advances.

III. Reinforce Competition and Commitment to Open, Free, and Contestable Markets to ensure a level playing field and to promote innovation, consumer choice, and access to high-quality financial services. The successful and large-scale adoption of technology would be facilitated by an enabling policy framework regardless of the market participant, underlying technology, or method by which the service is provided. Policymakers should address the risks of market concentration, and should foster standardization, interoperability, and fair-and-transparent access to key infrastructures.

IV. Foster Fintech to Promote Financial Inclusion and Develop Financial Marketsby overcoming challenges related to reach, customer information, and commercial viability, and by improving infrastructure. The evolving digital economy together with effective supervision are essential in overcoming long-standing barriers to financial inclusion across a broad range of financial services and in enabling developing countries to leverage promising new pathways for economic and financial development to support growth and alleviate poverty. Examples include expanding access to finance while reducing costs, providing new ways to raise funding, enabling new information services to assess risks, and spurring new businesses. To achieve these goals, fintech issues should be part of a national inclusion and financial and digital literacy strategies, while fostering knowledge-sharing between public- and private-sector players, civil society, and other stakeholders.

V. Monitor Developments Closely to Deepen Understanding of Evolving Financial Systems to support the formulation of policies that foster the benefits of fintech and mitigate potential risks. The rapid pace of fintech will necessitate improvements and possible extensions in the reach of monitoring frameworks to support public-policy goals and to avoid disruptions to the financial system. Information-sharing and exchange would support improved monitoring. Achieving these objectives brings out the importance of continuous monitoring—including by maintaining an ongoing dialogue with the industry, both innovators and incumbents—to identify emerging opportunities and risks, and to facilitate the timely formation of policy responses.

VI. Adapt Regulatory Framework and Supervisory Practices for Orderly Development and Stability of the Financial System and facilitate the safe entry of new products, activities, and intermediaries; sustain trust and confidence; and respond to risks. Many fintech risks might be addressed by existing regulatory frameworks. However, new issues may arise from new firms, products, and activities that lie outside the current regulatory perimeter. This may require the modification and adaptation of regulatory frameworks to contain risks of arbitrage, while recognizing that regulation should remain proportionate to the risks. Holistic policy responses may be needed at the national level, building on guidance provided by standard-setting bodies.

VII. Safeguard the Integrity of Financial Systems by identifying, understanding, assessing, and mitigating the risks of criminal misuse of fintech, and by using technologies that strengthen compliance with anti-money laundering and combating the financing of terrorism (AML/CFT) measures. While fintech innovation generally supports legitimate goals, some innovations may enable users to evade current controls for criminal ends, thus posing a threat to financial integrity. Country responses have varied considerably; but, in all cases, it is important to strengthen AML/CFT compliance and monitoring, including by using technology (Regtech and Suptech solutions) to support regulatory compliance and supervision.

VIII. Modernize Legal Frameworks to Provide an Enabling Legal Landscape with greater legal clarity and certainty regarding key aspects of fintech activities. Sound legal frameworks support trust and reliability in financial products and services. This is undermined, however, where legal frameworks fail to keep pace with fintech innovation and evolving global financial markets. An enabling legal framework can be fashioned by having clear and predictable legal rules that accommodate technological change, tailored to national circumstances, particularly in areas such as contracts, data ownership, insolvency, resolution, and payments.

IX. Ensure the Stability of Domestic Monetary and Financial Systems by considering the implications of fintech innovations to central banking services and market structure, while: safeguarding financial stability; expanding, if needed, safety nets; and ensuring effective monetary policy transmission. Fintech could transform the financial markets through which monetary policy actions are transmitted and could challenge the conduct of monetary policy as well as redefine central banks' role as lenders of last resort. On the other hand, fintech could help central banks improve their services, including potentially issuing digital currency, and expanding access to and improving the resilience of payments services.

X. Develop Robust Financial and Data Infrastructure to Sustain Fintech Benefitsthat are resilient to disruptions—including from cyber-attacks—and that support trust and confidence in the financial system by protecting the integrity of data and financial services. Developing such robust infrastructure raises a broad spectrum of issues that are relevant not only to the financial sector but also to the digital economy at large, including data ownership, protection, and privacy, cybersecurity, operational and concentration risks, and consumer protection.

XI. Encourage International Cooperation and Information-Sharing across the global regulatory community to share knowledge, experience, and best practices to support an effective regulatory framework. As new technologies increasingly operate across borders, international cooperation is essential to ensure effective policy responses to foster opportunities and to limit risks that could arise from divergence in regulatory frameworks. Sharing experiences and best practices with the private sector and with the public at large would help catalyze discussion on the most effective regulatory response, considering country circumstances, and to build a global consensus. The IMF and World Bank can help in facilitating the global dialogue and information-sharing.

XII. Enhance Collective Surveillance of the International Monetary and Financial System and the adaptation and development of policies to support inclusive global growth, poverty alleviation, and international financial stability in an environment of rapid change. Fintech is blurring financial boundaries—both institutionally and geographically—potentially amplifying interconnectedness, spillovers, and capital flow volatility. These developments could lead to increased multipolarity and interconnectedness of the global financial system, potentially affecting the balance of risks for global financial stability. The IMF and World Bank could help in improving collective surveillance and assist member countries via capacity building, in collaboration with other international bodies.

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