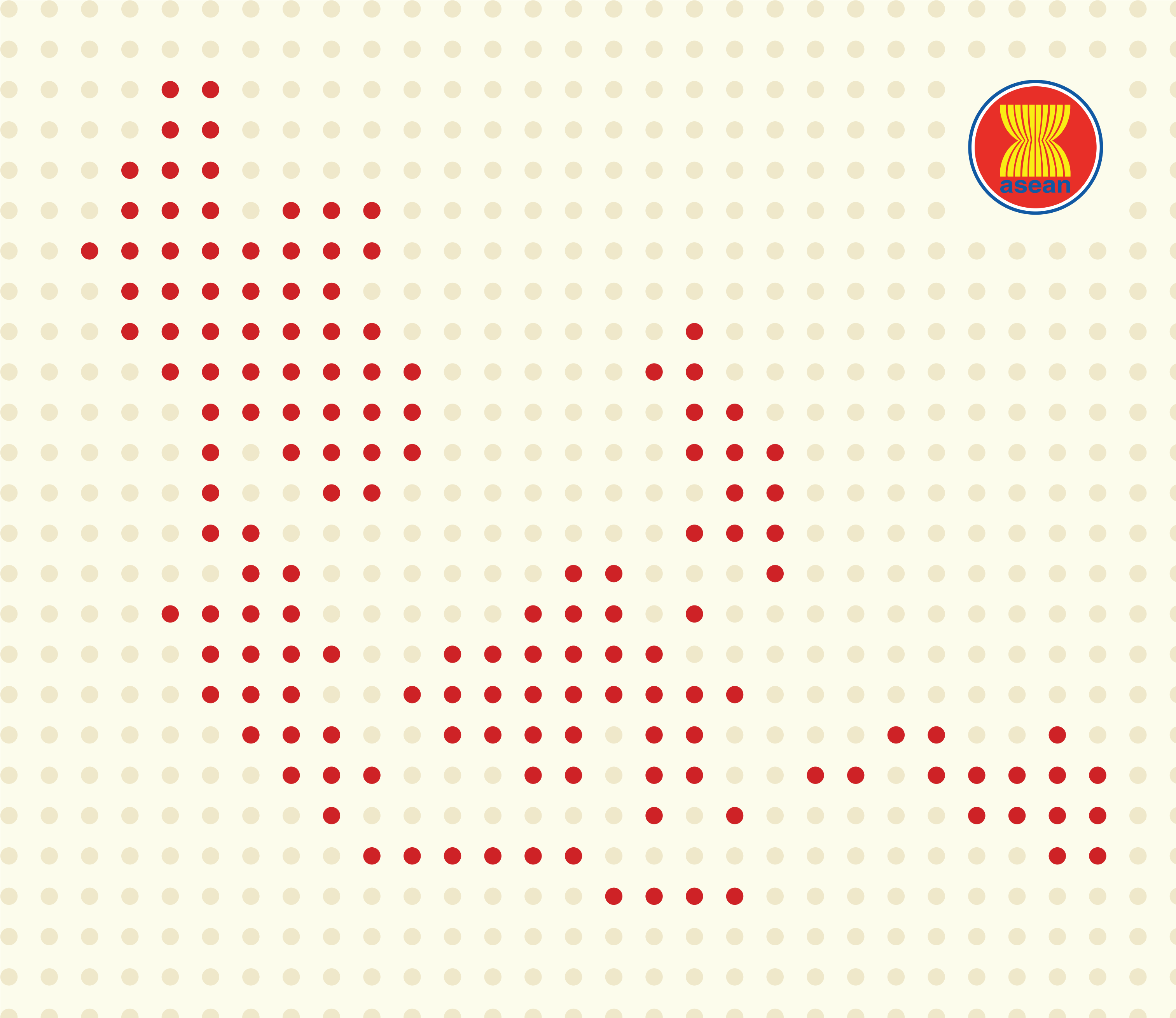

ASEAN GUIDANCE NOTES
ON DIGITAL FINANCIAL SERVICES

ASEAN Working Committee on Financial Inclusion (ASEAN WC-FINC)
2018

The ASEAN Guidance Notes on Digital Financial Services has been prepared on behalf of ASEAN WC-FINC. The guidance notes is aimed to provide a reference and also to further develope DFS and advance financial inclusion in the Southeast Asia region.

Abstract

It is widely acknowledged that digital financial services can help accelerate financial inclusion. This is especially important in Southeast Asia as the rise of digital technology in finance can bridge the gap left by more conventional financial firms, providing government opportunities to tap the people who were previously unserved. While the advantages are clear, regulators should also monitor the risks brought by the new technology.

The Guidance Notes will reflect on both opportunities and threats from digital financial services, focusing on five issues: (1) balanced innovation approach for financial inclusion, (2) legal and regulatory framework of DFS, (3) DFS infrastructure in ASEAN countries, (4) consumer education and protection, and (5) DFS data to support policies formulation. Each of these issues will be elaborated, with examples of initiatives that ASEAN governments can take to improve financial inclusion.

Background & Objectives

The Association of Southeast Asian Nations (ASEAN) acknowledges that digital financial services (DFS) are important to help achieve its goal in providing financial access, usage and quality of financial services to all segments of society, especially to the underserved consumers. With a large portion of population in ASEAN member states still lacking access to basic financial services, the advances in technology and developments in digital finance provide a solution to reach potential consumers who are underserved by enabling them to have access to and frequent usage of transaction accounts. Through digital channels, DFS creates effective and efficient financial access and inclusion to these consumers, thereby generating positive social and economic impacts to the general welfare at both national and regional levels.

While digital finance has rapidly expanded in the last decade, DFS development varies between countries in ASEAN, as it is linked to each country's level of financial system development. Countries with more developed financial system such as Singapore, Indonesia, Malaysia, the Philippines, and Thailand feature more progress in DFS policy and regulatory frameworks to support DFS development and managing its risks compared to the other members of ASEAN. There is also no clear definition of DFS between ASEAN member states, although broadly it is understood to mean financial services accessed and delivered through digital or electronic channels, amongst others, including the internet, mobile phones, automated teller machines, point-of-sale terminals, and so on.

The gaps in financial development between member countries may also pose challenges to the rapid expansion of DFS and financial inclusion in ASEAN region. Therefore, ASEAN member states should consider having standardized regulatory framework on DFS to facilitate financial inclusion and enhance the development of digital finance. In the light of this, ASEAN through the Working Committee on Financial Inclusion (WC-FINC) has agreed to establish the Guidance Notes on Digital Financial Services to serve as a reference for member nations in developing as well as regulating DFS in regard to financial inclusion.

The ASEAN Guidance Notes on Digital Financial Services will serve as a benchmark for ASEAN authorities and regulators in supporting DFS and financial inclusion in the scope of balanced innovation, legal and regulatory framework, infrastructure, consumer protection, and data platform. In addition to the Guidance Notes, cooperation and knowledge exchange among ASEAN members are also necessary to further develop DFS and advance financial inclusion in the region.

Rationale

DFS could significantly increase financial inclusion in ASEAN, where in two-thirds of member countries, less than 50 percent of the population owns an account at a formal financial institution. The rapid expansion of DFS through innovative technologies like mobile-phone-enabled solutions, electronic money models, and digital payment provides opportunities for many people who are previously untapped by conventional financial institutions to improve their lives. However, the development of DFS also requires regulatory support to ensure the consumers are well protected.

Currently the level of development of DFS and financial inclusion among ASEAN member states varies. The development of DFS is linked with the financial system development in a country, as shown with the existence of more digital finance players in bigger markets.

The preference of consumers to use conventional financial services rather than digital ones also poses challenges to the adoption of DFS, causing limited information, access, or infrastructure to DFS. The reason may be related to financial and technology literacy, as low-income populations may lack access and exposure to the knowledge of financial services or limited experience with electronic devices, which are crucial to increase DFS. To address this issue, regulators of ASEAN member states should encourage development of financial literacy programs that will serve as the primary foundation for development of DFS and financial inclusion.

As DFS advance, there needs to be a balance between the rapid evolution of digital and financial technology, as well as the policy, regulation, and risk mitigation. Regulators should be proactive in keeping up with the development of DFS since many of the products are new and come with unidentified risks, especially but not limited to protecting the low income segment of the society that is most prone to financial shocks. At present, there are many type of DFS products already serving the markets, including digital payments, crowdfunding, online lending, and digital investment products.

Clear and sound policy and regulatory frameworks would accelerate DFS development whilst addressing potential risks at the same time in order to achieve financial inclusion goals. Therefore, it is imperative that the governments of ASEAN member states establish national policy with strategic action plans, taking into account the respective country or national conditions. The policy and action plans could be based on international best practices, whilst the Guidance Notes could serve as a regional reference for ASEAN member states to further enhance DFS development and elevate financial inclusion to a more advanced level.

Guidance Notes

1 Balanced Innovation Approach for Financial Inclusion

Supporting innovation to expand the access and use of digital financial services in achieving financial inclusion targets, while managing any potential risks that could emerge.

Today technology has broadly opened up people's access to finance and is enabling greater and faster access compared to several years ago. The emergence of financial technology companies (known as FinTech) and the adoption of technology by incumbent financial institutions fill the gap in financial access, mainly for the financially excluded groups and underserved consumers. Innovation that comes along with the development of digital finance can advance financial inclusion with proper regulatory framework and risk mitigation in place.

The role of governments and regulators in ensuring that innovation in digital financial services can benefit financial inclusion is critical, since the rapid expansion of DFS may introduce new risks. Such risks need to be identified, managed, and mitigated effectively, and timely to ensure the soundness of the financial system without hindering the growth of digital finance innovation. Finding the right balance between opening up to support innovation and at the same time mitigating risks in developing DFS needs to be among the top agenda for regulators in ASEAN member states to ensure safety and reliability of products that can reach out to much broader consumer base in support of financial inclusion.

Examples of initiatives to balance innovation and risk in digital financial services in relation to financial inclusion include:

- Establishing the regulatory and/or industry networking aimed to facilitate broader information exchange of FinTech innovation and development.
- Creating regulatory or industry sandboxes which give digital finance participants opportunities to test out products and applications in controlled environment prior to public launch to serve consumers, thereby supporting innovation while preserving consumer protection.
- Identifying and examining use cases, effective and responsible DFS practices, and policy interventions, such as reforming existing policies and frameworks as needed to foster innovation, as well as to enhance understanding and/or ease adoption of emerging DFS technologies.
- Actively reaching out to digital financial services providers and consumers to better understand the dynamic development of DFS which in turn is expected to strengthen oversight.
- Establishing a FinTech dedicated unit or specific department responsible for FinTech and digital finance innovation.
- Coordinating and leveraging with international partners to provide resources, information, and services among ASEAN member states.

2 Legal and Regulatory Framework of Digital Financial Services

Providing an enabling and proportionate legal and regulatory framework which favors interoperability and ensures fair competition and transparency, in reference to international best practices.

A regulated digital finance will ensure that digital financial services can develop and expand in a sustainable manner, with controlled risks, to support financial inclusion. Since digital finance is relatively new and continuously being developed in high speed, authorities must keep pace with the development and build a legal and regulatory framework which reflect a "widespread understanding that financial inclusion, stability and integrity and consumer protection are not just compatible, but mutually reinforcing" as recommended by the G20 Financial Inclusion Action Plan 2014.

Policymakers are encouraged to develop legal and regulatory framework which favors interoperability and ensures fair competition and transparency. The framework may include:

i. A direction on skills, capacities, and resources development of DFS players;

ii. Appropriate risk management models;

iii. Proportionate supervisionof DFS; and

iv. Enhanced understanding regarding the alignment between financial inclusion, stability, integrity, and consumer protection.

Regulators in ASEAN member states are advised to refer to international standards in developing DFS for financial inclusion, and adopt the best practices which are applicable and in accordance with development in respective countries.

Examples of initiatives to develop an enabling and proportionate legal and regulatory framework of digital financial services include:

- Developing national strategies which reflect financial inclusion goals through close cooperation between the public and private sector stakeholders, such as by digitizing large-volume, recurrent payment streams (government payment programs, utility programs, employer payroll programs) via DFS providers, both banks and non-banks.
- Formulating implementation plans for DFS adoption and development according to specific focus areas, such as facilitating DFS mainstreaming in the MSME and agricultural sectors.
- Ensuring close coordination among regulators and authorities to avoid overlapping regulations that may hinder the development of DFS.
- Exchanging knowledge between less developed countries and more advanced countries in ASEAN. More standardized DFS regulations among countries can facilitate financial inclusion.
- Enhancing cooperation/joint work among regulators, authorities, and other stakeholders through measures addressing cross-cutting, cross-border issues and concerns that impede DFS development and mainstreaming.
- Applying risk-based AML/CFT measures, but with a certain degree of flexibility

to ease the provision of DFS. From a financial inclusion perspective, simplified due diligence measures can be applied to certain products or services that are less vulnerable to abuse.

- Enabling framework for payment system providers (PSP) which will allow them to grow, such as ad-hoc capital and risk management requirements. The large number of PSPs provides opportunities to leverage them for DFS expansion as cash in, cash out (CICO) outlets.
- Further developing e-money regulatory frameworks by expanding reporting requirements and data collection on e-money providers, allowing a wide range of activities including government transfers via e-money channels to facilitate financial inclusion.
- Ensuring that regulatory distinctions between banks and non-bank institutions or FinTech favor competition to accelerate DFS development.
- Integrating crowdfunding or online lending activities into the bigger financial ecosystem, such as by facilitating data sharing between conventional financial service providers and digital finance players, or feeding the data of crowdfunded borrowers into credit information systems.
- Developing cyber security strategies from a financial inclusion perspective, and incorporating risk-based approach that does not deter innovation.

3 Digital Financial Services Infrastructure in ASEAN Countries

Utilizing digital platform for financial services will lower costs for providers and consumers, while expanding the reach of financial access to all areas, including underserved rural areas.

One of the advantages of digital finance is the lower costs for both providers and consumers because it uses fewer resources, such as office branches and manpower. The advancement in information technology has become the primary enabler for digital financial services as it has changed both consumer and corporate behavior and helped reach the previously untapped consumers, regions, and markets, thereby supporting financial inclusion.

To develop a conducive DFS infrastructure as well as supportive ecosystem, policymakers in cooperation with the private sector should put in place effective coordination, monitoring, and evaluation framework through a national policy or strategy with clear vision and strategic action plans. Policymakers' guidance and surveillance, coupled with private sector's technical expertise and extensive ground work in DFS should therefore work in harmony to create an established DFS ecosystem. This can in turn provide users the convenience and reliability to facilitate digital financial transaction, including sending and receiving payments as well as borrowing and investing digitally.

Guidance Notes

Examples of initiatives to expand digital finance infrastructure in ASEAN include:

- Ensuring that key components that are necessary to support the development of DFS are in place, such as information and communications technology and reliable infrastructure such as electrical power, internet connectivity etc.

- Establishing a payment infrastructure that favors financial inclusion which includes: an interbank system for retail electronic fund transfers, such as ACH (Automated Clearing House); a platform to process payment cards; a large-value interbank settlement system, such as RTGS (Real-Time Gross Settlement); an efficient communications infrastructure; and an adequate identification infrastructure.

- Improving the accessibility, functionality and usage of retail payments, such as developing alternative real-time or faster-payment schemes, and national payment gateway designed as an interconnected and interoperable payment system.

- Connecting ID systems with financial infrastructure as a gateway for financial access could enhance DFS development and financial inclusion by facilitating know your consumer (KYC) procedures and ID-based accounts for digital banking, mobile money, and government assistance transfers.

- Providing more access points or branchless banking to facilitate the provision of financial services through digital means. Greater number of access points will favor the expansion of DFS.

- Approaching e-commerce from a DFS perspective as e-commerce companies can become a key player for financial inclusion and DFS development by co-opting consumers to become familiar with digital interface and make payments via digital channels.

- Addressing the role of mobile network operators (telecommunication companies) to ensure a fair and transparent competition with DFS as telecom companies play a key role in DFS expansion because they provide the main delivery channel.
- Exploring cloud computing and distributed ledger technologies (DLT), alongside the advantages and risks they potentially carry. Cloud services can speed up operations and reduces resources, while DLT allows faster authentication for a transaction.

4 Consumer Education and Protection

In order to encourage continual development and to ensure sustainability of DFS, consumer education and protection are increasingly important in ensuring that there is an enabling environment for digital finance. Consumer education is key to having consumers understand the nature of DFS and to foster trust and confidence; whereas consumer protection safeguards consumers through the power of laws, regulations and institutional arrangements.

Consumer Education

As the range of available financial products broadens and increases in complexity, consumers need to have sufficient knowledge and skills to understand the nature of DFS so that they are able to safely and effectively enjoy the benefits brought about by advances in technology, without being victims of cyber threats. Empowered DFS consumers are able to better make informed decisions on product choices, thereby enabling them to enjoy products which are more affordable and suited to their needs.

DFS providers as well as policymakers may choose to prioritize consumer education for the underserved, unbanked, and the low income segment, recognising their limited financial literacy and vulnerabilities in coping with financial loss.

Consumer Protection

A strong consumer protection regime would help build trust, and contribute to competitive financial markets. All financial consumers – including DFS consumers – should be treated fairly, equitably, and honestly at all stages of their relationship with DFS providers. Guidance can be embedded in provisions relating to transparency, product features and suitability, advertising and marketing strategies, and fairness of contract terms. DFS providers should provide consumers with accurate, understandable and not misleading information which covers fundamental benefits, risks and terms of the products.

Protection of consumer data is also increasingly important, and appropriate protection mechanisms must be in place. Data collection should specifically indicate the purposes for which the data may be collected, processed, held, used and disclosed. Consumers must also be informed about their rights to data-sharing, access data and promptly withdraw should the consumers desire so, without undue burden.

Consumers must be aware of their rights to protection, and access complaint resolution systems which are inexpensive, accessible, accountable, timely and efficient should problems arise. Consumers also have the right to seek redress for any errors on the part of DFS providers as well as for any illegal digital activities performed without their consent by other parties. DFS providers should have internal dispute resolution mechanisms. However, when complaints are not satisfactorily resolved through this manner, DFS users should be able to have recourse to an independent, impartial and free redress process.

Examples of actions to promote consumer education and protection include:

- Designing consumer protection frameworks which include the competency and capacity of consumer protection supervisors, transparency and fair rules, protection of consumer funds, and a sound complaint-handling mechanism.
- Prioritizing financial education and encouraging stakeholders to regularly launch financial literacy programs, financial awareness campaigns, trainings, workshops and exhibitions to promote smart uses of DFS. Information about DFS products and services can also be provided through online, interactive videos, seminar and courses sponsored by the government and private companies.
- Enhancing digital literacy and promoting responsible use of existing and emerging DFS technologies in order to broaden public acceptance and ease resistance that usually arise from perceived uncertainties and security concerns on the adoption of new technologies.
- Requiring a basic, but mandatory, finance course to be included in the school curriculum. It can be taught as a stand-alone subject or integrated into other subjects like mathematics, history or social science.
- Strengthen enforcement of consumer protection regulations including issuance of warnings to financial institutions, requiring providers to refund fees and charges, imposing fines and penalties, revoking the license to operate, and so on.
- Issuing fair treatment rules to protect consumers including requirements to provide products suitable to consumer needs, transparency over fees

and charges, and minimum standards for market conduct and how to treat consumers.

- Using mystery shopping tools, in which supervisors gather information on consumer experiences by posing as clients of financial institutions without the knowledge of the financial institutions.

5 Digital Financial Services Data to Support Policies Formulation

Comprehensive monitoring and evaluation system to develop data platform is necessary to support regulators in formulating the appropriate policies to leverage digital financial services.

To leverage digital financial services and achieve financial inclusion goals, regulators need a comprehensive monitoring and evaluation system to track DFS progress, which will facilitate policy formulation. The system should contain key indicators, data infrastructure, and evaluation activities of key programs from DFS providers. The data can then be used by regulators, and financial service providers through an agreement and close coordination, to formulate appropriate policies in response to real-world problems and practices in DFS.

Examples of initiatives to collect digital financial services data to support regulators in formulating policies include:

- Prioritizing the development of both traditional and new data infrastructures to support innovation in data gathering, storage, and management.
- Improving data collection from specific underserved segments, such as microenterprises and small and medium enterprises (SME).
- Developing the coverage and completeness of information on credit bureaus to

support financial inclusion and DFS expansion by providing critical information for financial service providers. Regulators should integrate new data sources and providers with the existing data information.

- Assessing potential risks related to data security, data management, and data privacy while creating guidelines for the use of non-traditional data (including big data). DFS providers and progress in financial inclusion could benefit from access to alternative data, by understanding recent trends as well as consumer preference and behavior.

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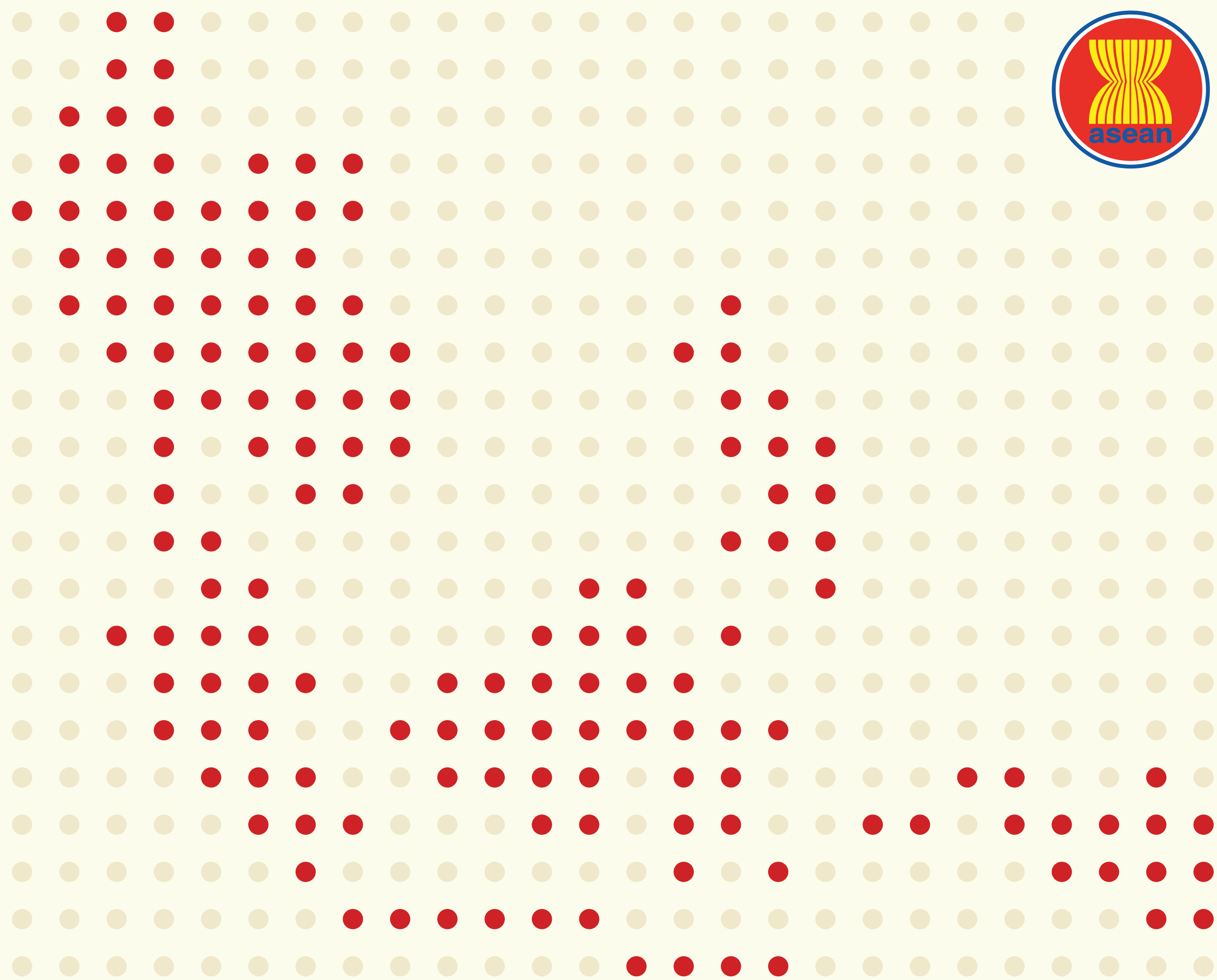

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