March 31, 2016

Mr. William Coen
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Re: BCBS Guidance on the application of the core principles for effective banking supervision to the regulation and supervision of institutions relevant to financial inclusion

Dear Mr. Coen:

The Institute of International Finance (the "IIF" or the "Institute") appreciates the opportunity to comment on the Basel Committee on Banking Supervision's ("BCBS" or the "Committee") consultation on guidance on the application of the core principles for effective banking supervision to the regulation and supervision of institutions relevant to financial inclusion (the "consultative document" or more generally, "the Guidance").

We value the Committee's review of the benefits and risks financial innovation and financial inclusion can introduce to the safety, soundness, and integrity of the financial system and we are grateful for the ongoing work in this area to help better serve the unbanked and underbanked around the world. The Guidance on the application of the Core Principles is one important step in the process to help banking supervisors and banks engage in a productive and constructive dialogue regarding the regulation and supervision of financial institutions serving unserved and underserved customers while maintaining sound prudential standards in the global financial system and a level playing field for all service providers.

While we agree with the overall direction of the Guidance, we submit that certain key areas would benefit from greater clarity and further consideration and discussion with the industry and we look forward to working with the Committee in this area, both through our comments on this consultation and via other appropriate fora. Should you have questions on our letter, please do not hesitate to contact me or Matthew L. Ekberg at mekberg@iif.com and Tomas Conde at tconde@iif.com.

Very truly yours,

Andres Portilla

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Introduction:

The financial services industry believes providing inclusive finance to the unbanked and underbanked around the world is crucial, and this area constitutes an important part of the ongoing work of the IIF. According to the World Bank, an estimated two billion people aged fifteen and over - more than half of the world's total adult population - do not have an account at a formal financial institution. Though we note the welcome improvement of seven hundred million people opening new bank accounts between 2011 and 2014, more needs to be done.

As the Committee knows, financial inclusion efforts seek to ensure that all households and businesses, regardless of income level, have access to and can effectively use the appropriate financial services they need to improve their lives. The benefits of financial inclusion are significant for economies as well, as it is linked to a country's economic and social improvement and plays a role in reducing extreme poverty. Recent research also indicates that financial inclusion is not only positively correlated with development and employment, but is generally believed to causally impact growth.

Taking these and other related issues into account, we welcome the efforts of the BCBS to enhance its financial inclusion agenda by working alongside the G20's Global Partnership for Financial Inclusion ("GPFI") and the United Nations ("UN") Secretary General's Special Advocate for Inclusive Finance for Development. We recognize the standard-setting bodies of the global financial sector are increasingly engaged in moving to incorporate financial inclusion explicitly into their work. We look forward to providing support and input for these ongoing efforts, including the current evaluation of the Core Principles. We hope in the near term these efforts will assist in bridging gaps in financing for citizens around the world.

Key Issues:

The recognition that the Core Principles is not a static document and should, when appropriate, reflect updates that support sound prudential management whilst balancing the needs of a changing economy and regulatory environment, is welcome. Accordingly, our comments herein aim to assist the Committee in ensuring that a considered approach to proportionality in the Core Principles is balanced with practical considerations for effective supervision of all applicable institutions. We hope these comments will also aid in the overall thinking of the Committee regarding its work in the broader financial inclusion and regulatory reform dialogue and will serve as a point of future engagement with the Institute in this area.

1. The practical application of proportionality

While proportionality is a critical component of the Guidance, the Institute believes the Committee should provide additional direction on a balanced regulatory and supervisory approach for financial inclusion. The Guidance should be more specific in ensuring comparability in the regulation and supervision of nonbank financial institutions and banks alike, while mitigating the possibility of a competitive disadvantage for banks that are prudentially regulated and supervised at a national level and through standard setting bodies such as the BCBS.

The Guidance suggests setting differentiated requirements by type and size of institutions. However, this approach could create level playing field concerns and give rise to regulatory arbitrage between actors that engage in similar activities, as small banks and large non-bank corporations both provide financial inclusion support. Although it's expected that the overall level of regulation would be different for non-banks and banking institutions consistent with the risk each provider represents, functional regulations impacting inclusion should be similar for all institutions providing similar services. Non-financial firms that provide financial services as one of their primary sources of activity should be subject to commensurate supervisory review. This should also be applied to new non-bank technology providers, including providers offering digital and technological transformation, to ensure comparability is maintained. Supervision and regulation should require the same level of standards for different actors developing the same service in the same circumstances without inhibiting innovation.

Proportionality, in most cases, should generally also lead to more streamlined approaches for firms with simpler or more limited business models. However, the Guidance seems to imply a "custom-made" or "tailor-made" approach. Though the Committee discusses specific mitigation strategies for certain risks that arise with financial inclusion, we respectfully suggest the Committee focus more broadly on strategies to make regulation more efficient for institutions serving the unbanked and underbanked, without compromising its effectiveness.

Lastly, the industry has concerns with the suggestion to substitute individual supervision with monitoring at sector or market level in some cases. We acknowledge that supervisors might face significant resource constraints when dealing with numerous, small and more diverse institutions relevant to financial inclusion and that this can hinder the on-site individual supervision that is the standard for regulated banks. However, we would propose that supervision should be conducted on an individual basis whenever possible, especially in the case of deposit-taking institutions, as placing supervision at market level might conceal the build-up of risk at an institutional level to the detriment of the wellbeing of the financial system.

2. Jurisdictional differences in prudential oversight

As the Committee is aware, there are sometimes considerable differences in the supervisory practices applied across jurisdictions around the world. As is noted in the Guidance, many of the unserved and underserved customers reside in countries that are not BCBS members and in recognition of this, the Guidance is intended to be useful to both BCBS member and nonmember countries, including those countries in which supervisors are striving to comply with the Core Principles and who may implement this Guidance gradually over time. However, in some smaller, less developed economies, both regulators and supervised institutions may not yet be ready to apply the Guidance fully. It may be helpful to make it a priority for the Committee, the Financial Stability Institute ("FSI"), and perhaps the Financial Stability Board

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("FSB"), to work with such countries, both to help them toward application of the Guidance, and to identify ways in which the Guidance should be adapted to their circumstance, to avoid creating undue burdens.[1]

3. Dynamic changes in financial inclusion services

The world of financial inclusion and financial innovation is evolving every day and we believe the review of supervisory and regulatory regimes in this area should not be static. A more fluid and regular dialogue among relevant authorities and the industry would facilitate the identification and mitigation of new risks and would help to find new ways to enhance access to financial services. This could be accomplished, for example, through a stakeholder consultation process that incorporates an affirmative role for all parties related to financial inclusion. Such dialogue at the local level could identify issues and appropriate solutions, within the framework of the Guidance. At the Basel level, such dialogue could facilitate promotion of the Committee's goals and the updating of the Guidance when needed.

We also believe that the Consultative Document does not fully consider guidance on the products and services currently evolving to meet the needs of the unbanked or underbanked in an active way. There is uneven coverage of products, services and business models in the Guidance and we believe regulators should be aware of, and take into account, the next generation of financial products, including the opening of digital bank accounts, the interoperability of electronic identification and lending money using mobile devices, to ensure innovation is not hindered. At the same time, new risks require the need to establish complimentary standards between countries and, as such, information sharing must increase. This is a possible missed opportunity in setting guidance and should be considered more closely as the inclusion agenda of the BCBS moves forward.[2] We acknowledge that it may be too soon to form extensive guidance for all these emerging areas, but it is important for the Committee to recognize and implement distinct efforts to analyze them, in addition to the attention paid to the supervision of financial institutions and credit providers. This requires a more dynamic, forward-looking approach than the one currently presented.

4. Coordination on developing areas of regulatory guidance

The Guidance presents a number of areas where supervisors are encouraged to take into account the impact of regulation on financial inclusion. For example, one of the key issues raised for ensuring inclusive finance is the application of the "risk-based approach", requiring financial institutions to adopt enhanced customer due diligence ("CDD") measures for

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[1] It is especially important for AML standards in weaker countries to be brought up to international standards, as the recent FSB report on correspondent banking recognizes in one of its four principles: Financial Stability Board; *Report to the G20 on actions taken to assess and address the decline in correspondent banking*, November 2015.

[2] The Swiss Financial Market Supervisory Authority (FINMA), for example, has recently published guidance facilitating video and online client identification, in addition to removing a number of unnecessary obstacles from its regulations. Such forward review and guidance can assist in providing certainty around technological changes, but must be dynamic in its application: FINMA, *FINMA Reduces Obstacles to FinTech*, March 17, 2016.

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transactions, regions or products that present higher Anti-Money Laundering ("AML") and Combatting the Financing of Terrorism ("CFT") risks, and permitting them to use simplified CDD measures where risks are lower.

We agree with the Committee that, where risks are accepted to be low, the regulator should have the option of permitting the application of simplified CDD measures. The appropriate employment by banks and other service providers of simplified CDD is indeed especially important as overly strict CDD rules can prevent unserved and underserved customers from accessing formal financial services and products and potentially increase the risk of money laundering and terrorist financing by shifting transactions to the informal economy. In principle, the concepts of the risk-based approach and simplified CDD measures have been broadly accepted; however, the conditions under which banks can *actually* use simplified CDD measures are not at all clear, and the risks to banks of failing to impose enhanced due diligence have become highly apparent.

The discussion around trends in compliance standards and the incentives to "de-risk" clients from high-risk or inadequately regulated jurisdictions is quite broad and should be considered by the Committee in its review of financial inclusion. The IIF provided an extensive review of issues around mitigating de-risking in its recent submission to the Committee on Payments and Market Infrastructures ("CPMI") in response to its consultation on the correspondent banking market.[3]

As the FSB has made clear repeatedly[4], it is highly important for there to be complete clarity to financial institutions as to what their KYC and CFT obligations are. Such full clarity on the application of the risk-based approach should be extended to financial inclusion products and to all providers of such products on an equal basis, to avoid unintended consequences and level playing field questions. Only with full clarity from the official sector about what is expected will the incentives to "de-risk" be mitigated and the existing uncertainties that impede innovation be dissipated.

The Institute stands ready to work with the Committee on the points of guidance flagged by the consultation to ensure a universal, consistent view is taken across all work streams of the BCBS, the CPMI, the Financial Action Taskforce (FATF), the FSB, and other authorities.

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[3] IIF/BAFT Letter to the CPMI on Correspondent Banking, December 2015: https://www.iif.com/publication/regulatory-comment-letter/iifbaft-joint-response-cpmi-correspondent-banking

[4] Financial Stability Board; *Report to the G20 on actions taken to assess and address the decline in correspondent banking*, November 2015.

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