SURVEY REPORT ON FINTECH FOR MSME ACCESS TO FINANCING
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BACKGROUND

LACK OF ACCESS TO FINANCE IMPEDES MSMEs’ GROWTH

Micro, Small and Medium Enterprises (MSMEs) are critical for the economic and social development of emerging markets, which account about 70 percent of jobs and half of economic activity worldwide and can be vital in providing employment.1

Small businesses employ a disproportionate share of disadvantaged groups, including least skilled workers, young people and women. This can be sustained and accelerated when they have access to finance.

However, access to finance for MSMEs remains as one of the main hurdles in many developing countries, impeding business growth. The issue of access to finance for MSMEs is typically at the top of the policy agenda in most countries, noting their significant impact on employment creation and overall economic growth. The International Finance Committee (IFC) estimates depict a striking financial gap of USD8 trillion between demand for finance by formal and informal MSMEs and the existing supply, and a 32 percent gender credit gap.2 Figure 1 illustrates the financing gaps of MSMEs in each global region.

Insufficient sex- and age-disaggregated data for proper risk assessment and high transactions costs of small loans are obstacles for MSMEs to access financing, especially for those who operate in the informal sector where transactions are not recorded. People in the informal sector typically consist of the urban poor, migrants, rural communities, women and youth. These groups often have low and/or irregular incomes, and many are informally employed. In some societies, women are not allowed to have accounts or credits under their name and, therefore, are not able to build a personal credit history. They continue to face legal barriers to land and property ownership and inheritance rights. As a result, women are often not able to meet the collateral requirements necessary to access formal credit even if they have a successful, sustainable and profitable business. These structural barriers make lending to them a risky proposition for formal financing institutions, which in turn, impedes their access to MSMEs financing from banks, financial institutions, and in some instances, real sector formal creditors.

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SOURCE OF FINANCING/CREDIT FOR MSMEs

The landscape of MSMEs access to financing ranges from traditional Financial Institutions (FIs), financing enablers, Non-Banking Financial Institutions (NBFIs) and Financial Technology (FinTech)

**FINANCIAL INSTITUTIONS**
- Full banking license, incumbent bank.
- Regarded as “formal banking system”.
- Source of consumer credit.
- Due diligence based on credit history in formal financing institutions.

**FINANCING ENABLERS**
- Financial/credit infrastructure.
- Credit guarantee scheme.
- Credit information system.
- Secured financing.

**NON-BANK FINANCIAL INSTITUTIONS (NBFIs)**
- Does not have a full banking license.
- Regarded as “informal banking system”.
- Source of consumer credit.

**FINTECH COMPANIES**
- Does not have any banking license and is unregulated.
- Provides alternative financial services products such as money transfer, lending platforms, and investment opportunities.
- Due diligence is based on credit history in formal financial institutions, utility payments, and other proofs of payments available by the consumer.
FINTECH COMPLIMENTS MSMEs FINANCING LANDSCAPE

The development of the MSMEs financing landscape reflects its growth and business development stage. The most vital stage for MSME development is during seed and start up due to its sustainability, where financing are merely from 3Fs (founder, family and friend), government grant and Microfinance Institutions (MFIs).

MSMEs in developing and emerging countries face financing difficulties at early stages as they are not micro nor as stable as established small enterprises for bank and financial institutions. Capital market through venture capital and business angle are another avenue for SMEs to seek financing during the early and expansion stages. Comparatively, larger SMEs with better credit worthiness have more chances of obtaining financing from banks and private equities.

As SMEs grow larger to pre-IPO and maturity stages, the forms of financing are more structured and complex, such as bond and capital market. Despite various financing means at every stage of MSMEs development, access to financing is identified as one of the primary challenges that impedes MSMEs growth.

In the developing world, an estimated of 65 million firms, or 40 percent of formal MSMEs are either unserved or underserved by financial institutions, resulting in a total credit gap of USD5.2 trillion every year or 1.4 times the current level of MSMEs lending.

In the last decade, FinTech innovations such as digital payments (e-wallets and mobile money), alternative lending (robo-advisors), and alternative financing (crowdfunding or P2P) have erupted and thrived in the financial services sector, changing the financial landscape and the way it operates and serves customers better. These innovations have also benefitted women individuals, households and women-led MSMEs.

FIGURE 2: GROWTH TRAJECTORY OF MSME
The resistance of conventional banks to lend to MSMEs hinges on the fact that many of these businesses do not possess fixed assets as collateral which translates to their financial ability to repay those credits borrowed, along with many banks not offering suitable products and services geared to the needs of the MSMEs market. Having acknowledged that many MSME, especially microenterprises, lack the capacity or resources to produce formal financial statements and documentation that enable financial institutions assess their repayment capacity and default risk, FinTech companies deploy technologies to get an accurate understanding of their cash conversion cycle. The cash conversion cycle is the time MSMEs convert investments in inventory and resource inputs into cash through sales of goods and services. This helps establish the cash generation terms of the business and thereby, help to determine their repayment capacity and enhance price transparency.

Additionally, alternative data, such as periodical utility payments, payments to e-commerce platforms, or other financial transactions made digitally, can create new sources of important financial information, reduce information asymmetry in the MSMEs credit market and overcome the barrier in providing risk assessment tools to formal financial institutions. Removing a key constraint on entry into the formal financial sector will not only encourage lending to MSMEs, but also permit those who are motivated to shift their economic activities from the informal sector to the formal sector. All of these factors can come together and be of particular benefit to women-owner and -led MSMEs.

FinTech companies that offer alternative financial services products such as money transfer, lending platforms, and investments expand opportunities for consumer and MSMEs financing. These companies operate on a due diligence business model that utilizes both traditional and non-traditional financial transaction data in their risk assessment, which eases the burden and costs of resource intensive due diligence checks and allows for a larger eligible consumer base.

FINTECH MITIGATES MSME CHALLENGES

FinTech and alternative data developments allow the doors of financial services for previously unserved or underserved customers to finally be open. This technology is particularly useful for sole proprietor and small businesses, especially those owned by women and women entrepreneurs, without formal history of collateral ownership and proper financial transaction reports, which are common amongst the informal economy operating in rural and/or remote areas, as suggested by the OECD.\(^3\) By leveraging on bigdata, financial service providers can assess their credit worthiness using alternative data from opt-in smartphone metadata to discover predictive delinquent behavioral patterns. Beyond the use of data for credit risk assessment, alternative data may also offer valuable granularity on customer preferences and behaviors that can be used to design innovative financial products and services that meet the unique needs of women and men. It also important to note however, that bigdata can suffer from algorithmic bias at the development stage and unless gender and age considerations are actively built into systems from the start exclusion, it can actually be unintentionally increased. Including the needs of the target groups at the outset and enhancing the gender-sensitivity of developers are key enablers in this area.

Traditional banks are investing in updating their lending practices but the emergence of an increasing number of FinTech companies attests to an increasing demand for fully digital, remotely accessible, responsible and affordable financial services. Giant online merchants (e.g., Amazon, Alibaba) have also started to offer financing options for small businesses, leveraging the wealth of online information on their trading history and business behavior.

While FinTech represents a small share of the total MSMEs finance market, it holds potential for unprecedented solutions to the main barriers that MSMEs face in information asymmetries, collateral shortage, and high transactions costs of MSMEs lending.

To regulate innovative market deployments, many AFI member countries, such as Kenya, Tanzania and the Philippines, are implementing proportionate regulatory approaches and adopting a “test and learn” methodology. These approaches may be precursors to the “regulatory sandbox” for FinTech that more than 30 jurisdictions globally have now implemented.\(^6\)


\(^4\) See Lerong Lu 2018, Case of UK.

\(^5\) For example, business borrowers at Funding Circle (UK) can expect a loan decision within 24 hours after they submit the online application.
KENYA’S MOBILE MONEY M-PESA

Users of the mobile money product M-PESA were able to weather adverse shocks with no disruption in consumption due to their ability to activate their social network and receive remittances during their time of need. In contrast, consumers who did not have M-PESA experienced a 7 percent decline in consumption. Adoption of FinTech services by consumers increased, from 16 percent in 2015, to 33 percent in 2017 and 64 percent in 2019. The FinTech revolution, together with the emergence of an alternative finance market, is changing the traditional ways of MSMEs finance and offers the potential for increased productivity and efficiencies in the way financial services are delivered. Not only have they increased financial inclusion, but they have also increased competition, driving prices lower and improving the quality of services offered.
Digital financial risks may also take other forms. They may arise from a combination of existing and new providers, new digital technologies, reliance on agent networks, the bundling of new products across multiple service providers, hidden cost structures, low levels of financial literacy/capability among vulnerable groups, especially women and youth, which could increase the risk of financial vulnerability associated with excessive borrowing and over indebtedness. Digital technology risks can appear across the entire Digital Financial Services (DFS) and markets value chain, including at the operational, settlement, liquidity, credit, consumer, and combating AML/CFT levels.

A regulatory framework that balances promoting innovation in MSMEs finance, as well as maintaining financial system stability that protects consumers and MSMEs, is therefore needed to promote the acceleration and adoption of FinTech solutions.

Aside from promoting innovative financing and bridging the credit gap, government and regulators have to ensure financial stability and apply a balanced macro mechanism approach credit provided through FinTech have the potential of being volatile with the risk of a pullback of credit provision to certain parts of the economy, if market stress leads to a loss of investor confidence. If FinTech credit growth encourages greater risk-taking by banks this can lead to an abrupt erosion in bank profitability, and it would imply broader stresses for the financial system.\(^6\)


7  See FBS, June 2017, "Financial Stability Implications from FinTech Supervisory and Regulatory Issues that Merit Authorities’ Attention".

### SOME REASONS THAT ALLUDE TO THE ATTRACTION OF MSMEs TOWARDS FINTECH SOLUTIONS FOR ACCESSING FINANCING\(^4\)

<table>
<thead>
<tr>
<th>HIGHER EFFICIENCY AND LOWER COSTS</th>
<th>MITIGATING INFORMATION ASYMMETRY</th>
<th>MORE DIVERSE SOURCES OF FUNDING</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; MSMEs can borrow money at lower rates, and investors get higher return margins.</td>
<td>&gt; FinTech platforms, using big data and artificial intelligence technology as soft collateral and for credit assessment, by performing credit background checks of potential borrowers are using data that is available on the internet and not just those belonging to a single entity.</td>
<td>&gt; Diverse financing and investment facilities to MSMEs, beyond traditional banks by individuals, high net-worth individuals and institutional investors via innovative facilitation, intermediation mechanisms and FinTech platforms.</td>
</tr>
<tr>
<td>&gt; Financial institutions have traditionally relied on an extensive branch network to operate their businesses, requiring heavy investments in properties, personnel, and IT systems.</td>
<td>&gt; Variables relating to businesses and their owners, where available online, are inspected including personal details (gender, age, marital status, educational level, working years), company details (company size, business sector), and financial expenditure patterns (loan amount eligibility, monthly repayment patterns, delinquencies in payments, e-commerce transactions, other e-transactions).</td>
<td>&gt; The primary source of funding for most commercial banks is deposits, although an increasing number of financial institutions have started to raise funds from the interbank market and money-market funds.</td>
</tr>
<tr>
<td>&gt; In contrast, many FinTech platforms depend solely on digital distribution channels and do not have brick-and-mortar branches, thus drastically cutting overhead and operations costs.</td>
<td>&gt; The credit evaluation process of FinTech companies is not only different, but also more comprehensive and inclusive.</td>
<td>&gt; By contrast, FinTech platforms, such as Peer-to-Peer (P2P) have no geographical limitations and can obtain funds from individual investors, institutional investors, hedge funds, and government agencies from anywhere in the world.</td>
</tr>
</tbody>
</table>
The usage of big data has amplified concerns around consumer protection, data privacy and cybersecurity.

Data protection and privacy concerns, such as revealing confidential information to third parties, the enablement of aggressive marketing practices, and security risks including fraud and identity theft have left regulators at crossroads when weighing the viability of FinTech as a recognized and regulated financial service. Financial regulators have much to mull over concerning the fast pace of technological change, the limited knowledge of the actual risks and their consequences for consumers in cyberspace, and the fragmented legal and regulatory data protection frameworks covering financial services in many countries.

SME FINANCE WORKING GROUP SURVEY
FinTech is now well recognized and utilized as an alternative source of financing for MSMEs. The AFI Management Unit conducted a Survey on FinTech for MSME Financing amongst SME Finance Working Group members, to establish a baseline on the current status of FinTech within the financing landscape and how the emergence of FinTech and digitalized data complements the financing ecosystem and policy implementation and national strategies, particularly from a regulators’ perspectives. The survey responses are made up of 22 AFI member institutions who are financial regulators and ministries, with highest participation from the Pacific Islands and Sub-Saharan Africa. The survey period was 03 September - 18 September 2020.

MALAYSIA: DEMOCRATIZING MSMEs FINANCING LANDSCAPE

Equity Crowdfunding (ECF) and P2P financing platforms represent a structured and viable alternative access to capital for start-ups and MSMEs. First introduced in 2015, there are now 21 market-based financing platform operators in Malaysia, including three new ECF and five P2P financing operators approved in 2019. The sustained growth of ECF and P2P financing in 2019 has largely benefitted the services sector.

For the ECF market, key beneficiaries include the ‘Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles’ and ‘Information and Communication’ sectors comprising 20 percent and 11 percent of total funds raised respectively.

The majority of P2P financing were directed to the ‘Wholesale and Retail Trade; Repair of Motor Vehicles and Motorcycles’ sector, which accounted for 42 percent of the total funds raised. In terms of investors, ECF and P2P financing platforms continued to attract strong participation of investors including retail and youth segments.

Source: https://www.sc.com.my/api/documentms/download.ashx?id=a0099ceb-8908-44d3-9399-95be83d8bf53
SECTION 1: LANDSCAPE OF MSMEs FINTECH FINANCING IN SME FINANCE WORKING GROUP MEMBER COUNTRIES

FinTech companies are considered new players within the financial ecosystem amongst most of AFI member institutions. From the survey respondents, 62 percent of members indicated FinTech companies are not local.

The Philippines shared that they do have homegrown FinTech companies in operation, such as FundKo, which offers online crowdlending that matches the borrower and the lender directly through their platform, and Acudeen, an online platform for receivables discounting. In Costa Rica, new FinTech companies offer credit to individuals as well to microenterprises through platforms such as the Emma (Easy Mobile Money Access) App. Amongst the services offered are, merchant and E-commerce, invoice lending and P2P/marketplace lending are top of the alternative financing options made available by FinTech companies in member countries. Other members offer business sheet business ending, reward/donation-based and equity crowdfunding.

Most FinTech services in countries are either regulated under the relevant banking act or Non-Bank Financial Institutions (NBFIs). An example of the incorporation of FinTech into a country’s regulatory infrastructure can be seen in the Philippines. There are countries that allow FinTech companies to operate without being regulated but have plans to develop a suitable regulatory framework such as the Maldives Monetary Authority (MMA).

THE PHILIPPINES

The Philippines Financial Sector Forum (FSF) created a FinTech Committee (FC) in 2018 to develop a framework for a shared regulatory sandbox for activities that cross regulatory jurisdictions and ensure alignment of regulatory responses to FinTech innovation in the sector. The FSF is composed of four financial regulators in the country, namely the Securities and Exchange Commission (SEC), the Insurance Commission (IC), the Philippine Deposit Insurance Corporation (PDIC) and the Central Bank of the Philippines (BSP).

The objectives of the Philippines FinTech Committee include:

- Establishing a cohesive and consistent approach in the areas of regulation, supervision, and policymaking.
- Building the capacity of Regulatory Authorities (RAs) for enhanced supervision and oversight readiness.
- Creating an enabling regulatory environment for FinTech innovation.
- Ensuring that FinTech innovation fulfills the regulatory goals of maintaining financial stability.
- Upholding consumer protection, cybersecurity, and data privacy.
- Preventing money laundering and other illicit activities and strengthening situational awareness through information sharing, enhancement of surveillance capabilities and continuous monitoring of the developments in the FinTech landscape.

Source: AFI SMEFWG Survey response from Bangko Sentral Ng Pilipinas (2020)

FIGURE 3: TYPE OF INSTITUTIONS THAT PROVIDE FINTECH SERVICES IN AFI MEMBER COUNTRIES, %

<table>
<thead>
<tr>
<th>Type of Institution</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal Financial Institutions (regulated)</td>
<td>44%</td>
</tr>
<tr>
<td>Non-Bank Financial Institutions (not supervised)</td>
<td>31%</td>
</tr>
<tr>
<td>Others - Known</td>
<td>15%</td>
</tr>
<tr>
<td>Others - Not known</td>
<td>8%</td>
</tr>
</tbody>
</table>
SECTION 2: FINTECH REGULATION AMONGST SME FINANCE WORKING GROUP

More than half SME Finance Working Group members\(^8\) have certain regulations/policy on FinTech companies for oversight and monitoring. In the process of regulating innovation, regulators are often faced with the task of balancing conflicting priorities such as market growth and competition with the integrity, safety and stability of the financial system.

With the establishment of appropriate regulatory frameworks, FinTech can contribute positively to the betterment of financial markets, including the economic well-being of the consumers and MSMEs, especially if this is done in a gender-sensitive manner; otherwise they risk exacerbating the credit gap for MSMEs.

Besides MSMEs financing, other enablers and services that are currently leveraging on FinTech include risk assessment mechanism, credit guarantor and registry, credit information bureau, wealth creation, insurance and others (mobile payment service). In **Afghanistan**, two regulations oversee the operation of FinTech companies: (i) Payment Systems Regulation and (ii) Electronic Money Institutions (EMI) Regulation. As for **Maldives**, while mobile payment services are regulated, other emerging FinTech service providers are not. The Maldives Monetary Authority (MMA) is developing a national payments infrastructure to enhance access for new entrants to the market, whilst developing the necessary regulatory framework for a conducive innovative and competitive environment in the industry.

These examples show the importance of designing and implementing effective regulations, taking into account financial stability, protection of investors, and supporting new financing channels for MSMEs. In addition, new financing models such as crowdfunding, that are increasingly emerging, may engage relatively inexperienced investors.\(^9\)

Conversations with regulators, FinTech associations and accelerators/incubators at the forefront of the

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\(^8\) Results is 50 percent of a total 22 responses was used as a proxy to gauge the results of the AFI SME Finance Working Group as a whole. There are a total of 59 member institutions in the Working Group as of 28 April 2021.

\(^9\) For details on measures to encourage innovation while minimizing risks, see “G20 High Level Principle of Digital Financial Inclusion,” 2018.
FinTech landscapes in the AFI network, revealed four key focus areas where regulators can contribute to a well-functioning FinTech Ecosystem, which are: organizational structure; capacity building and upskilling; engagement and outreach; and regulatory framework and incentives.

In pursuit of maintaining financial stability and protecting consumers, FinTech regulations would have to cross borders to have sufficient oversight on all the risk factors. Regulators need to have better international cooperation, as only 25 percent of the survey respondents admitted to having some form of regulatory arrangements with another country to mitigate FinTech legal issues. Solomon Islands engages regionally and internationally with the governments of supportive and neighboring countries, international standards bodies, aid partners, and others via the National Information and Communications Technology Policy (National ICT Policy) by the Ministry of Communications and Aviation.

Market stability and consumer protection are among the main elements for regulators to consider in this new field.

75 percent of members indicate the availability of customer redress mechanism for FinTech related complaints, fraud occurrences or incidences regarding MSMEs.

For example, the Central Bank of Russia Federation has a hotline number for complaints about financial sector services even though it is not specifically for MSMEs. In Ecuador, MSMEs can go to the Superintendency of Popular and Solidarity Economy (SEPS) where FinTech companies are registered, or they can present their claims to the judiciary, where there are also agents specialized in combating financial crimes. There is a special department within the Bank of Mozambique that is responsible for consumer protection where all complaints regarding the offer of financial products and services by the providers of these services are directed, however there is still no space for complaints about the services provided by FinTech, since they are not yet operating autonomously.

Engagement between regulators and FinTech association(s) is needed to understand the perspectives and concerns from both ends, to gauge the likely impact of emerging products on consumers and the regulatory framework, thus ensuring careful alternative financing options for consumers and MSMEs.
To keep up with technological developments, the public sector has developed learning modules on FinTech literacy, cybersecurity in the design of businesses, online platform operations, personal and business data protection for FinTech financing, and operating model of FinTech lenders, to create awareness and educate central bank staffs on FinTech opportunities and risk management. In the Philippines, as part of the BSP’s capacity building initiatives, the Financial Technology Subsector was established and comprises a Technology Risk and Innovation Supervision Department (TRISD). TRISD is primarily responsible for conducting onsite and offsite IT supervision of BSFIs to ensure safety and soundness of technology risk management processes, as well as establishing and maintaining a comprehensive, relevant, and flexible regulatory and supervisory framework relating to IT supervision. It is also charged with cybersecurity surveillance and oversight while promoting digital or FinTech innovation through BSP’s regulatory sandbox.

DFS also has benefits for financial providers; they can diversify their loan risk across many smaller accounts and thus, making a run on a financial institution less likely, especially as women have lower levels of non-performing loans than men. Additionally, DFS can also enhance financial stability and allow alternative ways to assess client risk, through big data and social media, ecommerce transactions, utility bill payments, and etc., to lower transactions costs and expand their reach and profits.

However, the rise of DFS and FinTech products also present new risks and threats, such as those stemming from opaque data privacy/data protection practices or systemic vulnerabilities from cybersecurity threats. These practices and vulnerabilities could undermine public confidence and trust in the financial system if it is not adequately protected/addressed. These concerns would be amplified in women, as it is widely understood that women’s confidence and trust in the use of formal financial services are not on the same level as those of men.

Regulatory Technology (RegTech) and Supervisory Technology (SupTech) are considerable solutions for the integration and regulation of FinTech into a country’s financial ecosystem and requires additional effort on the part of a central bank of financial regulatory body.

RegTech is any application or platform that makes regulatory compliance more efficient through automated processes and at lower costs. SupTech is the use of innovative technology to support supervision, helping supervisory agencies digitize reporting and regulatory processes, resulting in a more efficient and proactive monitoring of risk and compliance. These elements will be important in creating a safe environment for the usage and implementation of FinTech for MSME financing.

To keep up with the rapidly changing FinTech trends, innovation in regulation must be instilled across the regulatory ecosystem to ensure regulators can carry out their primary mandate for financial stability, integrity, and consumer protection. Regulators should also be up to date on recommendations and guidance set forth by the global Standard-Setting Bodies (SSBs) on new developments such as virtual assets. Key gender considerations also need to be integrated into the regulation at the outset and during any review of existing regulations and guidelines.

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SECTION 3: GOVERNMENT SUPPORT ON FINTECH

As much as we see opportunities emerge out of FinTech, the majority of respondents, at 87 percent, indicated that there is no government support available on the use of FinTech.

However, some members have taken the initiative to support this industry. In the Philippines, BSP pushes for an increasingly digital financial landscape, not just in the MSMEs environment, but have always been supportive in allowing a wide range of providers, including FinTech players, to enter the market and catalyze the development of financial products and services. In Solomon Island and Ecuador, the governments have allocated expenses (CAPEX/OPEX) for FinTech, while Costa Rica and the Seychelles provide government grants and investment for FinTech companies. These examples show Government acceptance and encouragement of the usage of FinTech within the financial ecosystem.

Fig 7: Government financing of FinTech for MSMEs, %

Both traditional alternative financing and FinTech-based financial providers may have different levels and approaches to financing terms across jurisdictions. Ecuador, Timor-Leste and Mozambique find FinTech providers easier to fund compared to traditional alternative financing services, whereas Papua New Guinea and Seychelles have opposing views. Costa Rica, Solomon Islands and Suriname indicate both FinTech providers and traditional alternative financing services are equally easy to fund. The mixed perspectives of financial regulators towards this new technology are indicative of its instability and risk, and despite the benefits it can bring to MSMEs and individual users, it leaves much to be fully comprehended by many regulators in the developing world.

Regarding the benefits, we asked SME Finance Working Group members on existing use cases. Members indicate that aside from MSMEs financing, credit information bureau, credit guarantee and registry and wealth creation for savings and investment are among the top enablers that leverage on FinTech in their operations. FinTech usage in the Maldives is seen in mobile payment services whilst the Philippines utilize it for e-KYC, digital-centric banking, sustained adoption of e-money, and use of virtual currency exchange. Timor-Leste use FinTech mostly for cash in, cash out and transfer fund, and Mozambique is in the midst of undergoing tests of the FinTech products with the resolution of regulatory aspects. Although sparse, these examples share that there are potential opportunities when regulators and financial supervisors can collaborate with FinTech players and, perhaps, a “test and learn” methodology can be considered via the adoption of regulatory sandbox, drawing on the good practices and learnings from the implementation of sandboxes across over 30 member jurisdictions.11

Private-public dialogue becomes more pressing especially as we are amidst COVID-19, which has forced most of the world to transact digitally.

As seen in AFI’s Member Policy Response Dashboard, new digital financing initiatives are implemented at the same rate as national economic stimuli and, where the country case examples will illustrate, are complementary to the delivery of such stimuli. COVID-19 has presented an unexpected opportunity to make further use of digital channels to reach these unserved and underserved groups, improving financial inclusion. These examples of AFI members shed light on successful collaborations and its benefits:

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After the strict COVID-19 lockdown measures, which were imposed in March, began to impact the economy, the Moroccan government released an emergency fund aimed at supporting low-income people. Grants ranged from MAD90 to MAD130 per month depending on household size and were disbursed in April and May.

Barid Cash, a digital payment systems provider, became one of the disbursements centers of these payments, once a Memorandum of Understanding was signed between the FinTech company and Bank Al-Maghrib (Central Bank of Morocco). As Government-to-People (G2P) recipients visited Barid Cash outlets to collect their grants, the FSP attempted to incentivize them to open mobile payment accounts, and thus, shift from cash to account-based government transfers. Barid Cash used several methods to encourage the opening of mobile payment accounts, including:

- Waiving the costs on mobile payment accounts for G2P beneficiaries.
- Adding useful services such as water and electricity payments and mobile top-ups.
- Conducting an information campaign to highlight the advantages of mobile payment accounts.

To catalyze e-wallet/mobile payment take-up, Bank Al-Maghrib, temporarily simplified account opening procedures during the pandemic, allowing customers to open a basic payment account by keying in the client’s phone number and digitized national ID card.

MALAYSIA

In June 2020, Malaysia issued its fourth economic stimulus package, named the Pelan Jana Semula Ekonomi Negara (PENJANA) or National Economic Recovery Plan, which is primarily aimed at helping businesses recover from the impact of the coronavirus pandemic.

Some of the measures issued in PENJANA include new tax incentives, financial assistance for small and medium-sized businesses (SMEs), and job protection initiatives.

For the rural community, the package will provide MYR108 million (US$25 million) to help the most vulnerable members of society. A one-off MYR300 (US$70) payment are provided for:
- 190,000 registered disabled persons
- 150,000 single mothers who are below the poverty line
- 2,000 volunteer home help services

The Malaysian government has utilized e-wallets for the disbursement of MYR750 million (USD180 million) for G2P payments. A new Mastercard study shows about 40 percent of Malaysians surveyed are using mobile/e-wallets more, followed by debit cards (26 percent) and contactless credit cards (22 percent).

Malaysia leads other countries in Southeast Asia in the usage of mobile/digital wallets at 40 percent, ahead of the Philippines (36 percent), Thailand (27 percent) and Singapore (26 percent).

SECTION 4: INVESTMENT AND LENDING-BASED CROWDFUNDING

Technology platforms increase the efficiency of transactions, frequently making use of alternative data for customers who lack formal credit histories. They also provide new investment opportunities for consumers and investors, expand access to credit, and promote competition in many developed and developing markets.

MALAYSIA

In November 2020, the Malaysian government tabled their national budget, which revealed emphasis on creating a digital economy receptive towards alternative financings such as Equity Crowdfunding (ECF) and P2P Financing. The government is allocating MYR50 million (USD 13 million) to the My Co-Investment Fund (MyCIF) and an additional MYR10 million (USD2.5 million) will be allocated to the same fund, specifically for social enterprises fundraising via P2P Financing platforms. This is the 2nd time that the government has allocated MYR50 million (USD 13 million) to co-invest at a 1:4 ratio for ECF and P2P financing platforms.

This practical support will not only help to fund creditworthy MSMEs but also bring awareness to the public about ECF and P2P Financing — a much-needed platform to help MSMEs grow. Both the public and private sectors appear pleased that the government is increasingly recognizing the important role that FinTech plays in society. More FinTech-friendly policies are eagerly awaited from the government of the day.

Source: https://fintechnews.my/25429/various/budget-2021-fintech/

Six survey respondents namely the Costa Rica, Haiti, Mozambique, Papua New Guinea, Philippines, and Suriname have P2P financing platforms that are able to service households and MSMEs in economic activities including agriculture and farming, energy and green technology, and ICT. We also found most respondents do not know the default rate of lending-based crowdfunding platforms available in their countries.

In Ecuador, the Superintendencia de Economía Popular y Solidaria (SEPS) shared their default rate of less than 2 percent and in Papua New Guinea, it is between 2 percent - 3.5 percent. For loan disbursement, Ecuador, Haiti, Mozambique and Suriname indicate P2P financing or lending platform take more than 14 days to disburse credit loans. The range of loans disbursed by P2P lending platforms ranges from USD1,000 to USD40,000 amongst respondents.

The low response rate towards P2P lending platforms and other crowdfunding services could indicate the infancy of these services in the market. Respondents indicate that amongst the challenges towards adopting these services as alternative financing for MSMEs are the absence of government incentive to use lending-based financing platform, lack of awareness, and lack of understanding on its potential risks.

The survey also found that most MSMEs are keen to explore newer technologies for financing due to its quick attainment rate.

However, they do not necessarily take the step to engage these new services as penalty rates are not attractive enough. Overall, investment and lending-based crowdfunding platforms do not have high visibility/activity amongst the SME Finance Working Group member institutions. In their view, most MSMEs prefer traditional banking platforms as a source of funding.
SECTION 5: DATA PROTECTION AND PRIVACY

The emergence of big data and artificial intelligence has amplified concerns around data privacy. Members are aware of threats to consumer protection experienced by MSMEs when accessing alternative finance options with newer technology.

Most institutions do not have regulations to inform consumers of the ability of FinTech companies to access private data, those who are within the areas of commercial transactions, electronic communication platforms, and social media. However, about 70 percent of respondent (Afghanistan, the Philippines, Ecuador, Suriname, Papua New Guinea, Samoa, Solomon Islands and Mozambique) indicate there are government agencies that are tasked at implementing cybersecurity on a national level. In the Philippines, the BSP has a comprehensive set of regulations in response to the increasing propensity and sophistication of cyber-attacks involving fund transfers, payments and other transactions via online channels.

Most survey respondents indicate they do not have any initiative or program to inform MSMEs of the risks pertaining to data and consumer protection due to a lack of demand, as MSMEs business operations are not impeded by issues in this area. This is due to the fact that many of the MSMEs are made up of micro-enterprises, which operate in the informal sector and due to their unregulated nature, such issues may not be reported to financial regulators or central banks. Existing programs focus on FinTech literacy are very rudimentary in nature without going into the details of risks of engaging alternative financing FinTech platforms. It would benefit members of the AFI network to learn from each other; an exemplary model portrayed in Thailand is depicted below:

THAILAND

In Thailand, the results from the Thai Households Financial Literacy and Access Survey conducted by the Thai National Statistical Office (NSO), in collaboration with the Bank of Thailand (BOT), suggest that there is room for improvements in the areas of financial inclusion, and financial literacy. The Thai regulators have thus adopted a strategy to help promote the ability of the financial sector to serve the consumers better through:

(1) Development of interoperable digital financial infrastructures, starting with digital payment to serve as a foundation for FinTech innovations, which could be further leveraged into other financial services such as digital banking products such savings and borrowing that better meet customer needs

(2) Adoption of supportive laws and regulations that will allow for more FinTech innovations and adoption

(3) Recognizing the importance of financial literacy

Thai regulators as well as the private sector have embarked on various initiatives to promote financial literacy, with the aim of not only improving people’s financial knowledge, but also to nudge them into seeking better products to meet their specific needs.

SECTION 6: CREDIT INFORMATION SHARING

Unlike the practices by traditional banks, the use of Big Data can allow MSMEs to be assessed beyond their traditional credit profile.

Alternative data enables banks to make informed decisions and helps those underserved or not served with formal credit to join the mainstream financial ecosystem. In fact, using alternative data is no longer just a benevolent option for banks; they are increasingly feeling compelled to do so because their FinTech competitors are aggressively leveraging it for business expansion.

Powering better credit decisions with FinTech by expanding to new market segments, such as the New-to-Credit (NTC), new-to-bank, thin file, millennials and self-employed, lower the cost of risk by leveraging the predictive capability of AI and Machine Learning to consistently improve digital scorecards while lowering the cost of risk and deriving faster decisions, shortens the time-to-yes from days to less than 1 minute, with scores delivered in real time. Similarly, the survey found most institutions believe that FinTech companies use commercial transaction data to evaluate the risk level of MSMEs. Additionally, institutions are aware that data from social media platforms and communication tools, such as SMS and email are used for risk assessment by FinTech companies.

Information credibility and transparency is another vital element in assessing the data. Most respondents indicate they do not know the status of MSMEs data transparency that is used by FinTech companies to evaluate MSMEs credit rating, nor do they know if there is any regulation that bounds them for the data and ensures the accountability of the personal data use. This would also allude to the lack of knowledge on transparency requirements or laws on this matter.

In the nutshell, alternative data may not replace the formal credit sourcing system, but it can be an effective equalizer for the unserved and underserved market. When used responsibly, alternative data can contribute to greater financial inclusion and banks that leverage it will have a competitive edge over those relying strictly on traditional credit metrics.

FIGURE 9: KNOWN DATA SOURCES USED BY ALTERNATIVE FINANCING COMPANIES THAT USE FINTECH FOR ASSESSMENT

<table>
<thead>
<tr>
<th>Data Source</th>
<th>Count</th>
</tr>
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<tbody>
<tr>
<td>Commercial transactions</td>
<td>6</td>
</tr>
<tr>
<td>Commercial transactions</td>
<td>5</td>
</tr>
<tr>
<td>SMS and Email</td>
<td>5</td>
</tr>
<tr>
<td>None</td>
<td>5</td>
</tr>
<tr>
<td>Real estate lending providers</td>
<td>2</td>
</tr>
<tr>
<td>Utility providers</td>
<td>2</td>
</tr>
<tr>
<td>Others</td>
<td>1</td>
</tr>
<tr>
<td>Customer review platforms</td>
<td>0</td>
</tr>
</tbody>
</table>
CredoLab looks to alternative data to assess credit risk. CredoLab evaluates smartphone and web metadata to produce digital scorecards allowing lenders to make better decisions, especially for thin-file and underbanked people. CredoLab uses POS decisioning among other methods to help companies find reliable customers from those whose credit worthiness cannot be accurately assessed by traditional PII methods. With the pandemic driving more and more commerce to digital channels, such solutions are needed.

CredoLab’s offering fits the bill as it has been tested in parts of the world that are beginning to emerge from the pandemic and shown not to lose its predictive power. It was also tested before and during the pandemic and the predictive power of the digital scorecard did not change.


CASE STUDY: BANK ISLAM (MALAYSIA) PARTNERS GLOBAL PSYTECH TO OFFER CREDIT RISK ASSESSMENT SOLUTION

Bank Islam Malaysia Bhd and Global Psytech Sdn Bhd are collaborating to offer an innovative credit risk assessment solution called General Financial Insights (GFI). GFI will contribute to bridging the financing gap that affects MSMEs and further catalyze MSMEs contribution to Malaysia’s economy.

Bank Islam said GFI would estimate the risk of providing financing to an applicant, even in the absence of a traditional credit history. GFI allows a financial institution to finance with confidence to aspiring entrepreneurs who might otherwise be sidelined from the financial system, particularly those in the MSMEs sector.

SURVEY OBSERVATIONS & RECOMMENDATIONS

Although FinTech is pioneered by the developed countries, the dynamism of financial ecosystems in emerging economies is seen in the success of mobile money applications, which use alternative data, thus showcasing their fast-paced advancements.

From the responses of the various SME Finance Working Group Members, it can be concluded that FinTech not only refers to digital payments but also acts as an additional source of credit, alternative capital and financial enabler within the MSMEs financing ecosystem. Investment and lending-based crowdfunding are prominent among members, particularly via crowdfunding platforms and Peer-to-Peer (P2P) lending.

Technology platforms increase the efficiency of transactions with the use of alternative data for customers, such as women and youth, who lack formal credit histories.

Members identified that DFS and FinTech can enhance financial stability and can also allow alternative ways to assess client risk through big data, however, DFS and Fintech also present new risks and threats to data privacy or systemic vulnerabilities from cybersecurity threats. On data protection and privacy, majority of the respondents have government agencies that are tasked with implementing cybersecurity on a national level. However, from the public perspective, there is lower perceived risk of data and consumer protection, as MSME business operations are mostly informal with little effect for these concerns.

RegTech and SupTech are considerable solutions for the integration and regulation of FinTech into a country’s financial ecosystem and requires additional effort on the part of a central bank of a financial regulatory body. Regulators need to find a balance in designing and implementing effective regulations that considers financial stability, protection of investors, cross-thematic topics and vulnerable groups such as women-led MSMEs, and also supports new financing channels for MSMEs without stifling the market.

RECOMMENDATIONS

1. Conversation with regulators, FinTech associations and incubators to understand the perspectives and concerns from both ends and identify focus areas that need government intervention for a well-functioning and comprehensive FinTech ecosystem.

2. Create more platforms for public awareness and financial intermediary staffs on FinTech literacy, cybersecurity, online platform operations, personal and business data protection for FinTech financing, and operating model of FinTech lenders.

3. Regulators should also be up to date on recommendations and guidance set forth by the global SSBs on new developments such as virtual assets and data protection. Key gender considerations also need to be integrated into the regulation at the outset.

4. Private-public dialogue has become more pressing, especially amidst COVID-19, which has forced most of the world to transact digitally.

5. Digital financial literacy campaigns should, therefore, focus on building trust through the dissemination of accurate and unbiased information on different types of FinTech products and services, including their benefits and risks.
# ACRONYMS AND ABBREVIATIONS

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Meaning</th>
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<tbody>
<tr>
<td>AFI</td>
<td>Alliance for Financial Inclusion</td>
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<tr>
<td>AML</td>
<td>Anti-Money Laundering</td>
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<tr>
<td>API</td>
<td>Application Programming Interfaces</td>
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<td>BOT</td>
<td>Bank of Thailand</td>
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<td>BSFI</td>
<td>BSP-Supervised Financial Institutions</td>
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<td>BSP</td>
<td>Central Bank of the Philippines</td>
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<td>CFT</td>
<td>Countering Financing of Terrorism</td>
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<td>CNBV</td>
<td>Comisión Nacional Bancaria y de Valores (Mexico) / National Banking and Securities Commission (Mexico)</td>
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<td>DFS</td>
<td>Digital Financial Services</td>
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<td>ECF</td>
<td>Equity Crowdfunding</td>
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<td>FC</td>
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<td>Financial Institutions</td>
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<td>FinTech</td>
<td>Financial Technology</td>
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<td>Financial Sector Forum</td>
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<td>FTI</td>
<td>Financial Technology Institution</td>
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<td>G2P</td>
<td>Government-to-Persons</td>
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<td>GFI</td>
<td>General Financial Insight</td>
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<tr>
<td>IC</td>
<td>Insurance Commission</td>
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<tr>
<td>ICT</td>
<td>Information and Communications Technology</td>
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<tr>
<td>IFC</td>
<td>International Finance Committee</td>
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<tr>
<td>KYC</td>
<td>Know Your Customer</td>
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<td>MFI</td>
<td>Microfinance Institutions</td>
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<td>MMA</td>
<td>Maldives Monetary Authority</td>
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<td>MSMEs</td>
<td>Micro, Small and Medium Enterprises</td>
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<tr>
<td>NBFI</td>
<td>Non-Banking Financial Institution</td>
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<td>NFES</td>
<td>National Strategy for Financial Education</td>
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<td>NFIS</td>
<td>National Financial Inclusion Strategy</td>
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<tr>
<td>NTC</td>
<td>New-to-Credit</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>P2P</td>
<td>Peer-to-Peer</td>
</tr>
<tr>
<td>PDIC</td>
<td>Philippine Deposit Insurance Corporation</td>
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<td>RA</td>
<td>Regulatory Authority</td>
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<td>RegTech</td>
<td>Regulatory Technology</td>
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<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<td>SEPS</td>
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<td>Small and Medium-sized Enterprises</td>
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<td>SME Finance Working Group</td>
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<td>SSB</td>
<td>Standard-Setting Body</td>
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<tr>
<td>SupTech</td>
<td>Supervisory Technology</td>
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<tr>
<td>TRISD</td>
<td>Technology Risk and Innovation Supervision Department</td>
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REFERENCES


