

Risk-Based Supervision for Inclusive Digital Financial Services

TRANSCRIPT: Introduction to Risk-Based Supervision

A risk-based approach to supervision is the most effective way to not only achieve proportionality but also to support more inclusive Digital Financial Services.

Here are five steps to guide supervisors in the implementation of risk-based supervision.

Step 1: Map goals to objectives and risks

The first step is to articulate policy goals and map each goal to specific DFS supervisory objectives. Once these goals are mapped, supervisors can identify the main risks to achieving each of them. This mapping, along with the associated risks, will depend on the regulatory framework and the affected DFS providers.

For example, the central bank law may state that a supervisory unit is responsible for ensuring the safety and efficiency of the national payment system, as well as the payment services providers and the protection of their users. One of the objectives under the goal of payment system efficiency can be achieving interoperability. An associated key risk may be a dominant DFS provider that refuses to interconnect with competitors.

In the risk identification process, it is important to focus on inherent risks posed by similar providers. These are different from the residual risks (or net risks) posed by an individual provider resulting from its risk management and mitigation tactics.

Step 2: Identify impact indicators and develop a risk assessment methodology

The key to implementing risk-based supervision is to identify priorities and to assess the impact of the materialisation of risks. That is why the second step in implementation is to identify factors or indicators that you can use to measure this impact. These indicators help supervisors identify and prioritise the DFS providers that deserve the highest level of attention.

Examples of measurable impact indicators include asset size, market share, and number of customers. Once the indicators have been identified, supervisors must establish a methodology to assess each risk for each DFS provider. This methodology needs to be designed to help understand how inherent risks become net risks and should also address how to prioritise the risks based on an initial assessment.

Step 3: Conduct impact and risk assessments

Step 3 is to track and measure the identified key impact indicators. This helps supervisors better understand the level of inherent risks associated with each DFS provider, as well as various categories of providers.



Conducting this assessment is a critical prerequisite to the risk-based supervision approach. If the application of this approach is new, supervisors will need to carry out an initial comprehensive risk assessment for all DFS providers and compare them to one another. This will form the basis for future risk-based assessments.

All subsequent risk assessments that are part of ongoing supervisory activities won't need to be comprehensive and won't need to cover all types of risks. This is because each assessment will build on the initial risk assessment and focus on priority areas.

Step 4: Prioritise risks

DFS supervisors do not have enough time to continuously conduct full assessments of all risks for each provider under their remit. Therefore, they need to prioritise the risks within each DFS provider. To do this, the initial focus should be on the risk assessment itself, as this highlights the most salient risks with each DFS provider.

However, once a high number of providers are under supervision, it becomes important to develop a risk matrix, which assigns weights to different risks faced by a DFS provider and can produce an overall score for each provider.

It is important to note that risk matrices are not an exact science. Each supervisory unit can use different weights and consider different risk factors and mitigators in their matrices.

To ensure alignment across supervisory departments, promote knowledge sharing, and maintain ahead of emerging risks, it is advisable for supervisors to hold and attend annual brainstorming sessions with other departments or authorities. This provides an opportunity to learn from one another and identify emerging risks that may not have been captured in earlier assessments. It will also provide insight as to leading risks and which issues need to be prioritised.

Step 5: Build a supervisory plan

Once all four of the previous steps have been completed, it is possible to develop a well-informed plan of activities for the supervisory cycle all year. This plan needs to include the allocation of staff time and expertise, ensuring that this is mostly allocated to the most important risks and providers.

When designing the plan, supervisors should not forget to leave some staff time to deal with emergencies, unexpected risk events and issues that were not captured during the risk assessment.

The outputs of these steps are not static, especially in the fast-evolving Digital Financial Services industry. Over time, supervisors may refine their understanding of the relative importance of various risks and identify new ones.

Risk-based supervision is a dynamic, continuous, and adaptable cycle of planning, implementation, and feedback. Swift changes must be introduced when needed. Such changes could include changes to the articulation of policy goals and supervisory objectives, the identification of new or different indicators, and the risk assessment methodology itself.

Throughout this adaptive process, the quality of data collected and data analytics capabilities also play an important role. So, supervisors must ensure that they use high quality and up-to-date to inform their risk assessments and supervisory plans.

