

Challenges and Progress in Developing Regulatory Approach to Alternative Finance Providers in Georgia

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Content

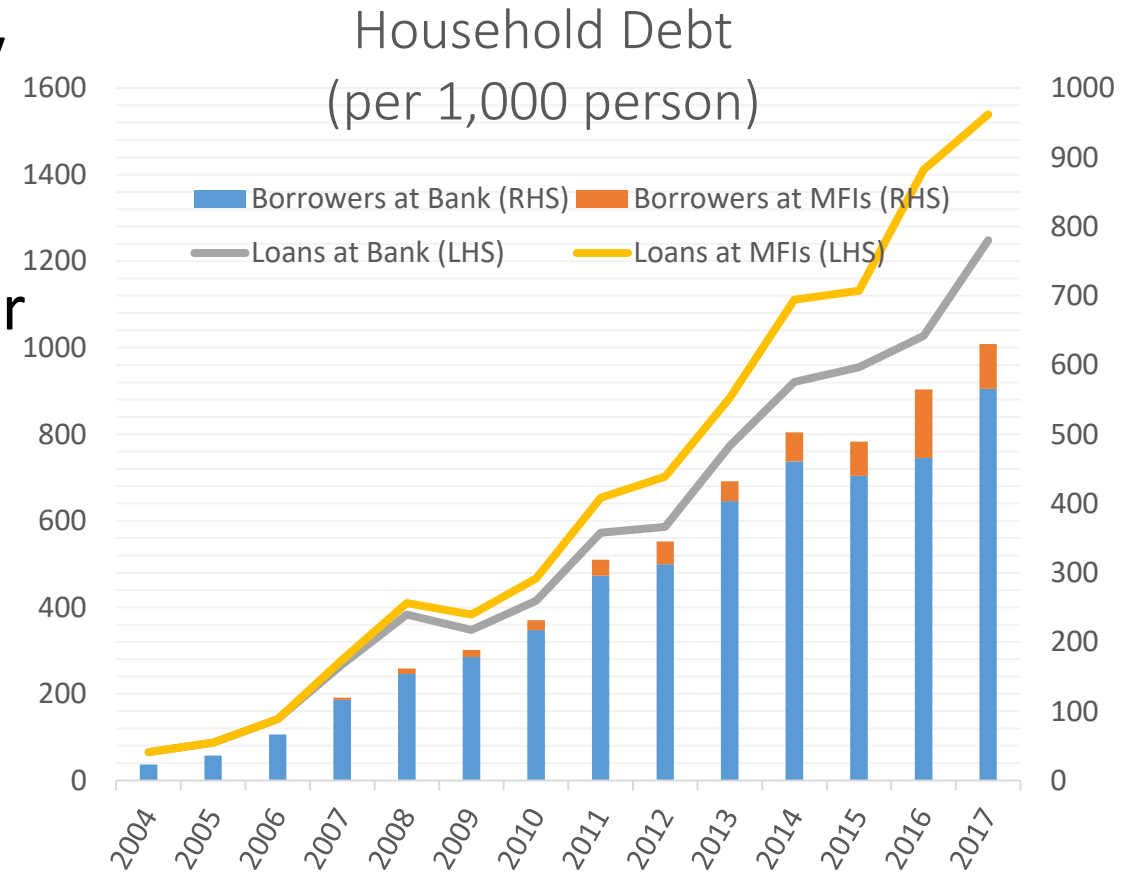
- History of alternative finance in Georgia
 - Journey from access to finance to overindebtedness problem
 - Expanding view on financial stability
- Risk Based Regulation 2.0 - balance between innovations and risks
 - OpenRegulation framework
 - Implications for the development of alternative finance and crowdfunding models

A large, reddish-brown ceramic jar (qvevri) is in the foreground, slightly out of focus. In the background, there is a vineyard with rows of green grapevines under a clear blue sky. The text "History of Alternative Finance in Georgia" is overlaid on the left side of the image.

History of Alternative Finance in Georgia

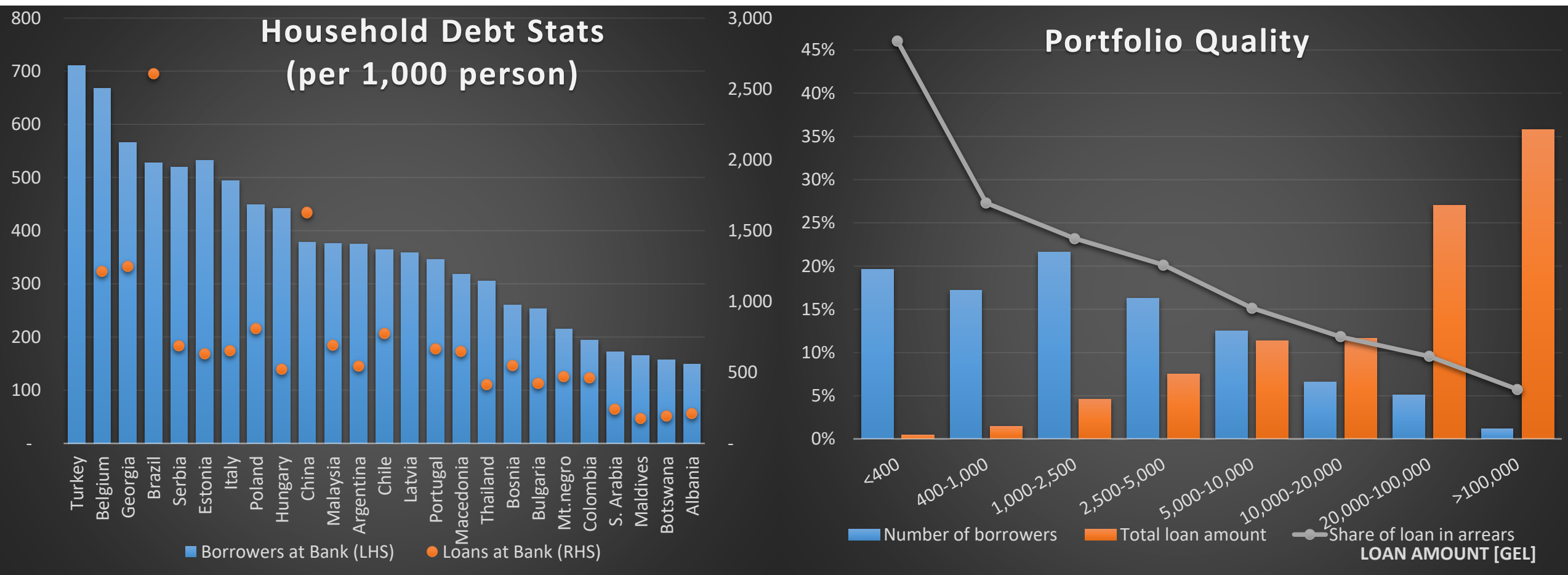
From access to finance issue to indebtedness risks

- Up to mid 2000s retail credit was basically nonexistent. Major challenge was to get a loan.
- Subsequent “pro-credit” reforms and liberalization has created fertile ground for credit expansion. Regulation was concentrated to ensure solvency of the banks and protect depositors.
- Banking sector becomes highly developed and transparent.
- In mid 2010s Alternative Finance Fintech firms exploited areas beyond regulatory perimeter and access previously “unbankable” sectors.



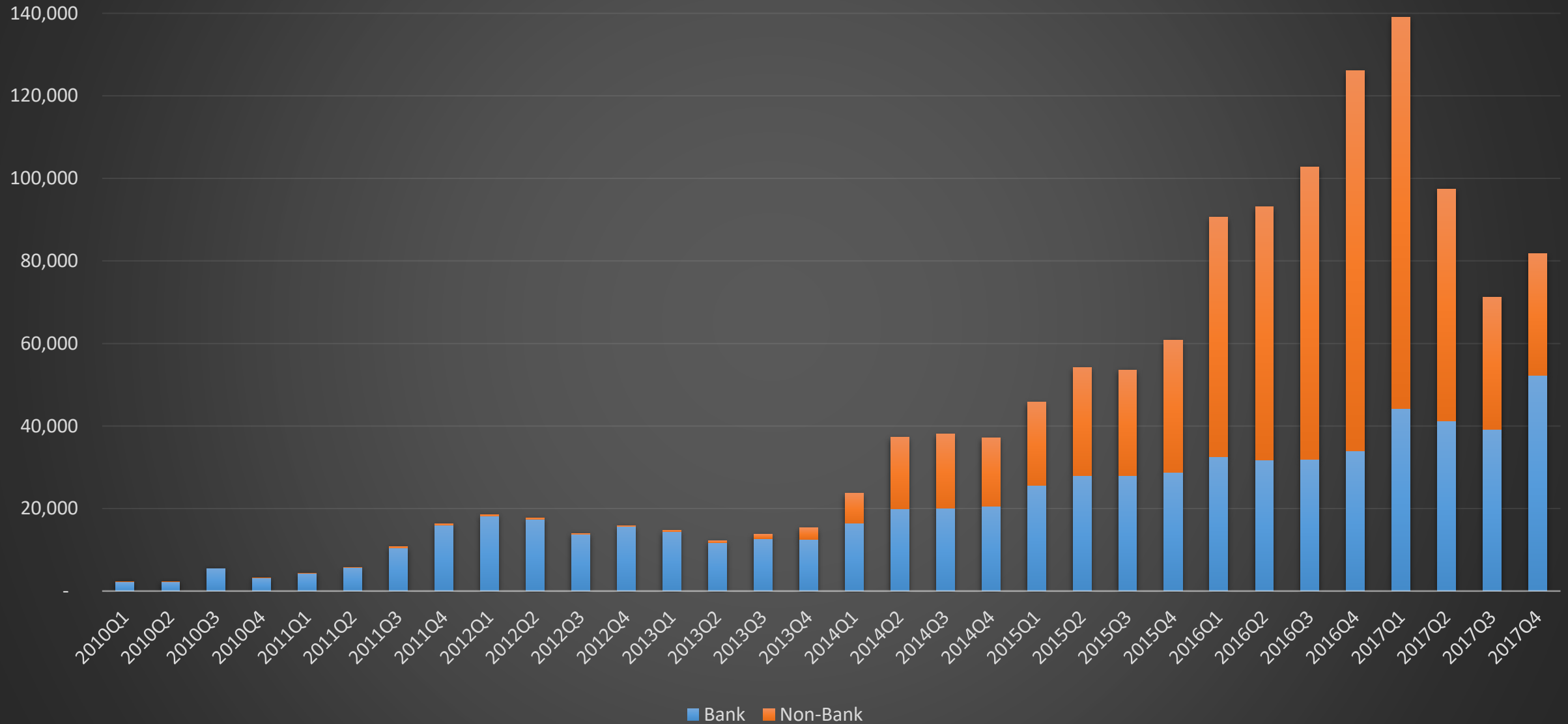
Source: IMF

As housed debt grew low income buckets became particularly vulnerable



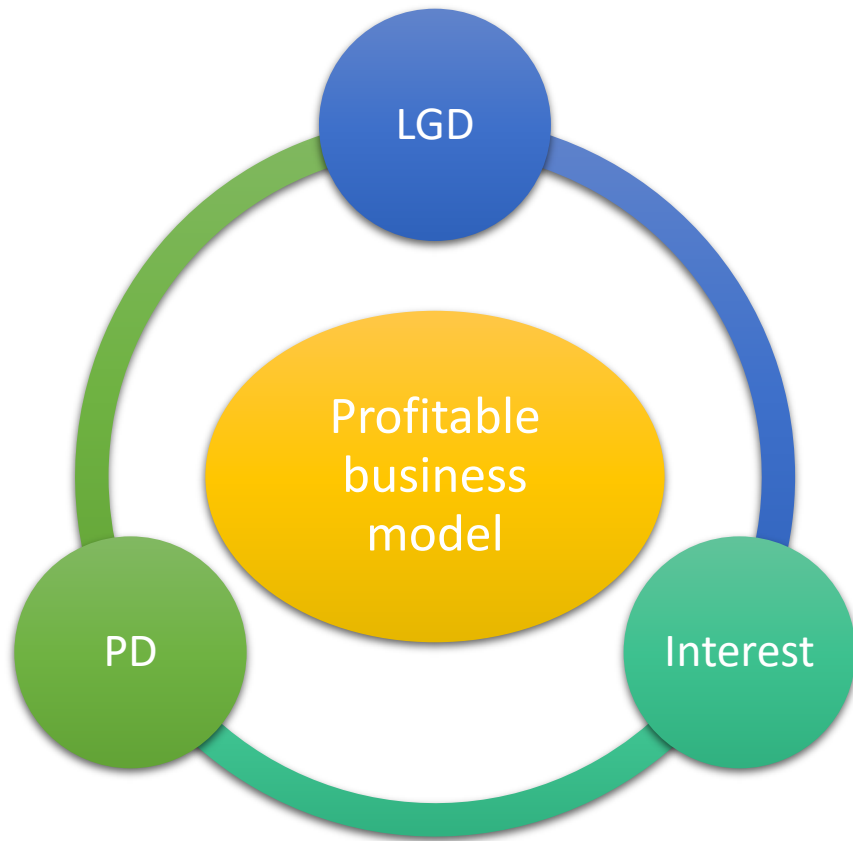
>30d Overdue Loans

OF LOANS



Source: NBS estimations.

Expanding view on financial stability



Profitable vs. Sustainable equilibria.

There are many combinations of these 3 variables that can result in profitable business model. However, not all equilibria are socially optimal and can result in predatory lending.

This externality motivated case for regulatory intervention.

Measures to solve overindebtedness via measures targeting PD has synergy with supervisory process.

Other specific factors on the local market:

- History of Ponzi schemes - Especially many following break-up of Soviet Union.
- Low financial literacy – Despite of dramatic measures to increase product transparency from 2012 it had limited effect on retail market efficiency.
- Problems with rule-based regulations – In microfinance and unregulated sectors lending retail depositors with qualified investors.
- Cost of Equity - Credit market is relatively well developed. However, equity market (public as well as private) is not developed and capital is extremely expensive.
 - Any solution addressing this problem will have high marginal value added.

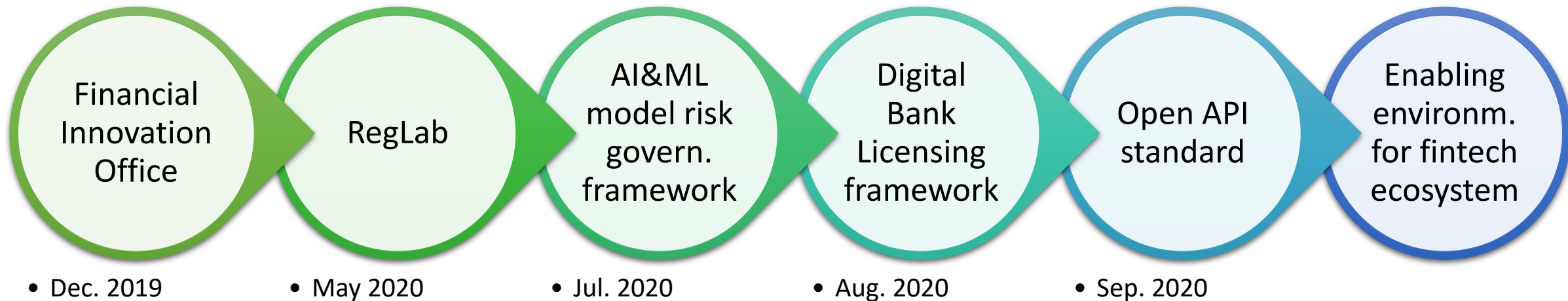
Risk Based Regulation 2.0 finding balance between innovations and risks - Georgian experience



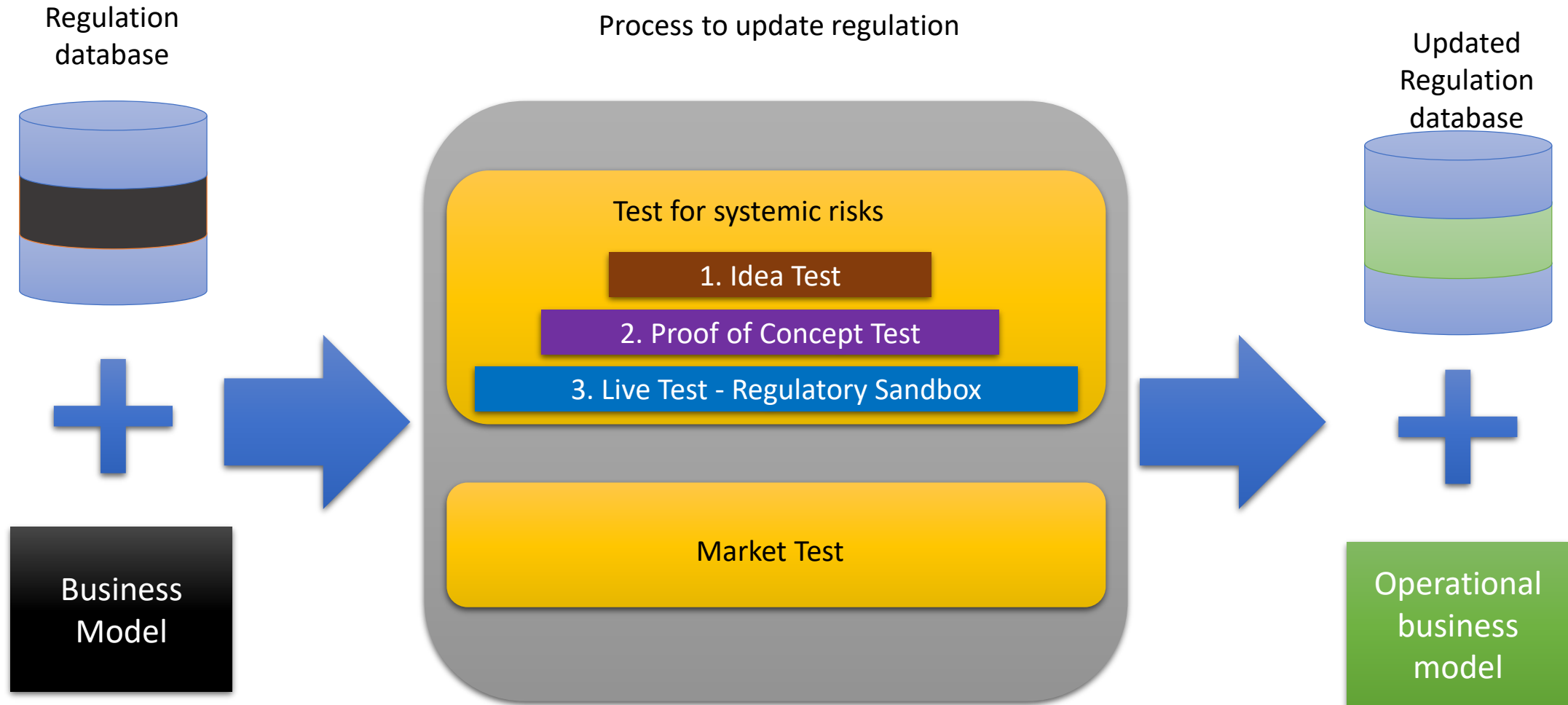
Updating regulatory approach - thinking about balance

- To address these concerns, over past several years regulatory approach was expanded in depth and in scope.
 - Retail lending guidelines.
 - Microfinance – prudential requirements.
 - Unregulated sectors became regulated.
 - Predatory lending became constrained by EIR/penalty caps.
- Not to have negative impact on innovations, facilitation of fintech ecosystem become priority.
 - Technology neutral approach in supervision.

Fast tracking regulatory developments to help development of fintech ecosystem in Georgia



Developing OpenRegulation Framework in Georgia



What does all this implies for development of alternative finance and crowdfunding models?

- OpenRegulation and RegLab framework creates environment to test and tailor crowdfunding model on Georgian market.
- Also, new approaches and products could be experimented and exported to new jurisdiction.
 - Georgia is GFIN member and participant in global regulatory sandbox.
- Two priorities for regulatory framework:

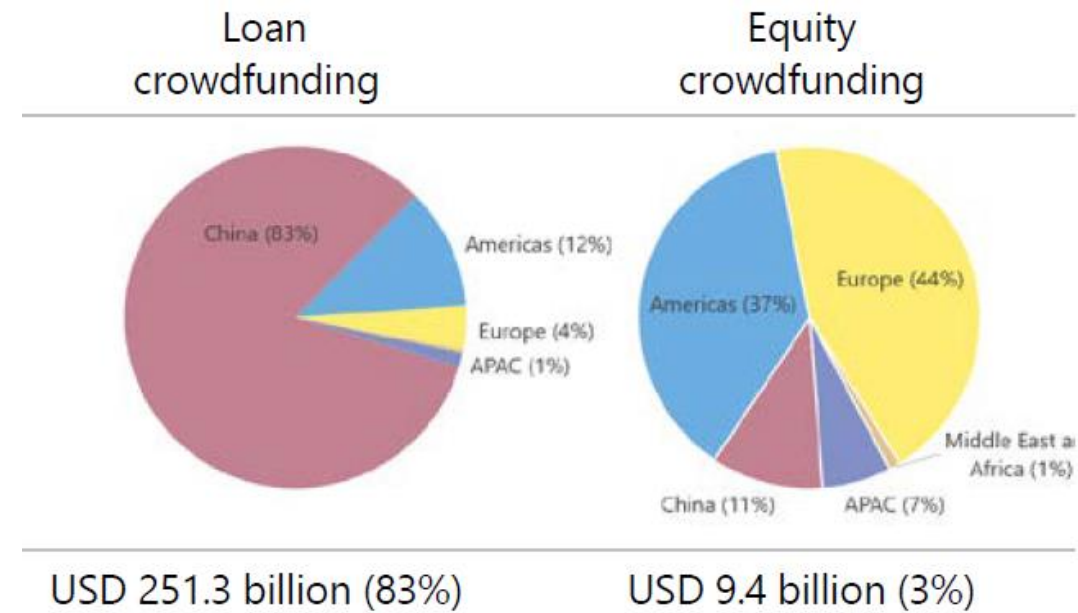
Operational
resilience

Consumer
protection

Focus of regulatory framework in case of crowdfunding platforms

1. Authorization required for the operation of platforms.
2. Platforms' governance requirements.
3. Prohibition of risk transformation (other than diversification).
4. Capital requirements.
5. KYC rules and AML checks required.
6. Maximum size of offer and maximum investable amount.
7. Consumer protection measures, including type of investor disclosures.
8. Risk warnings.
9. Due diligence/pre-funding checks.
10. Conflict of interest.

Although not as widespread as loan crowdfunding, equity crowdfunding represents major interest.



Source: [BIS \(2020\)](#)



Where do we go from here?

- Digital bank framework – example of RegLab framework in action.
- Financial innovation office – gateway for RegLab application.

