EMBEDDED FINANCE PRESENTATION

FSCA

Agenda

- **Embedded Finance Introduction & Trends**
- **Embedded Finance Use Cases**
- **Embedded Finance Survey Insights**
- **Implications to the Financial Sector**
- **Panel Discussion**

Embedded Finance (EmFi) is growing, and it is projected to be the mainstream financial service in the next 10 years

- Worldwide value of venture capital investments in EmFi exceeded **$4 billion** in September 2021.
- Global opportunity for EmFi is estimated to reach **$7 trillion** in the next 10 years.
- EmFi is currently worth **$3.5 trillion** in the global retail sector.
- The retail sector will account for **49%** of the EmFi market within the next 10 years.
- The **Buy-Now-Pay-Later (BNPL)** scheme another form of EmFi, is becoming the most common e-commerce payment method in most countries.
- **Mastercard and Visa** are integrating BNPL into their products and South African companies are also incorporating BNPL into their offering.

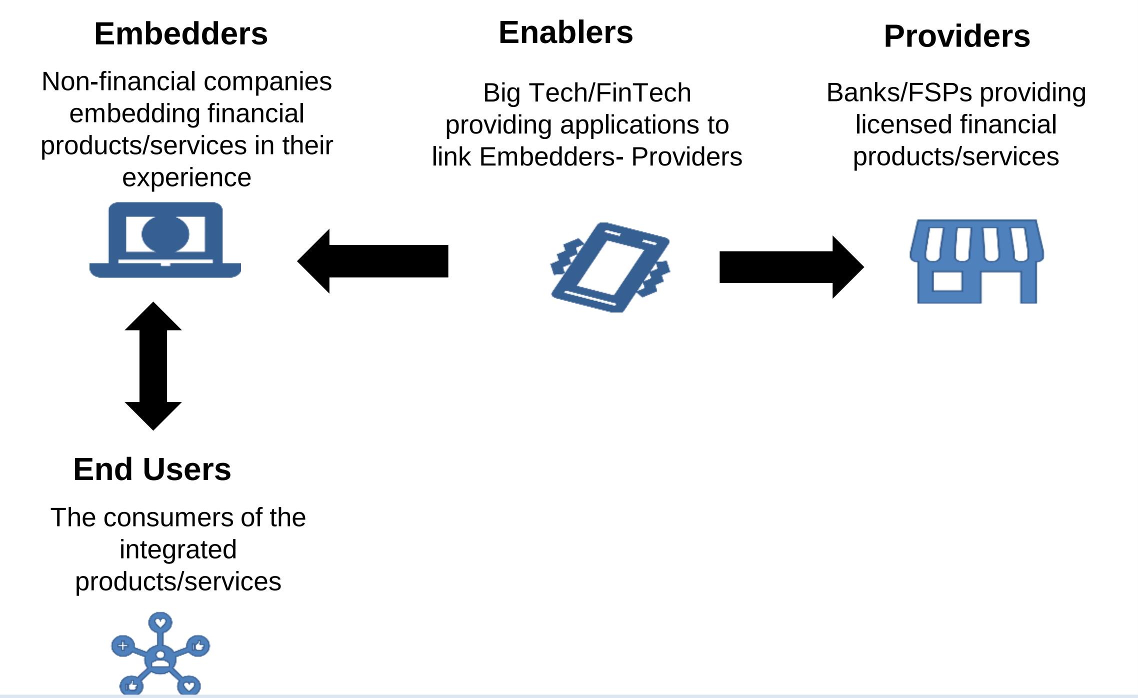
Source: Journal of Internet and Digital Economics 2022, Businesslive article 2022

What is Embedded Finance (EmFi)?

Definition

Embedded finance (EmFi) can be defined as the incorporation of a financial service or product into the platform of a non-finance company, organization or institution or EmFi is when non-financial companies or organizations include financial services as part of their services. EmFi permits the integration of *loans*, *insurance*, *payments*, *savings* and *investment instruments* in the platform or process of a non-finance company, organization or institution.

EmFi Ecosystem



Participants	Role Embedded Finance	List of Service
Providers	Banks/FSPs who are holders of financial licenses providing financial products/services	Payments Lending Insurance Investment
Enablers	Application providers linking Embedders-Providers enabling them to exchange data, information and services	BaaS & Data security Credit & Money movement Data Connectivity &Verification Compliance & Data Insights
Embedders	Non-financial companies providing products and service and acting as the user touchpoint.	
End Users	The ultimate consumers of the integrated product offerings.	

Various factors are driving growth in EmFi activities

1 New consumer behaviors

- More and more customers are increasingly open to conducting financial services with alternative providers to banks.

2 The rise of financial APIs

- New technology capabilities such as APIs open the door for easier integration of financial services into any online retail store.

3 Embedded payments

- Companies can embed payments directly into their products. This trend is now expanding to other businesses thanks to innovations offered by payment processors.

4 Business need for new revenue streams

- EmFi has a potential to enable businesses in every sector to generate new revenue streams or augment their existing revenue streams.

Globally, several jurisdictions have introduced varying approaches to regulate some of the EmFi activities e.g., BNLP

Australia

- The **Australian Finance Industry Association (AFIA)** in collaboration with BNPL providers proactively developed a voluntary Code of Practice for the BNLP sector aimed at increasing consumer protection.
- The Code is intended to:
  - Promote a customer-centric approach to the design
  - Marketing and distribution of a BNPL product or service
  - Promote high industry standards of service for customers
  - Build best practices across the BNPL sector
  - Support compliance with legal and industry obligations

United States of America

- Some state laws require BNPL providers to register as lenders while some states for instance, California do cover BNPL.
- **The Consumer Financial Protection Bureau (CFPB)** has also issued guidelines for BNPL providers outlining potential consumer risks.
- There is evidence of with some providers operating under the US Regulation Z – a federal law aimed at protecting customers and standardising how lenders describe the scope of their business.

United Kingdom

- **The Financial Conduct Authority (FCA)** has plans to protect consumers through the amendment of interest-free BNPL credit agreements.
- Under the plans:
  - Lenders will be required to carry out affordability checks;
  - Amend financial promotion rules to ensure BNPL advertisements are fair, clear, and not misleading.
  - Brands will require approval from the FCA
  - Borrowers could take their complaints to the Financial Ombudsman Service (FOS).

Singapore

- Singapore has taken more of a "bottom-up" approach to the task of integrating BNPL into current legal frameworks.
- **The Singapore Fintech Association (SFA)** under the guidance of Monetary Authority of Singapore (MAS) has launched a BNPL Working Group to develop a code of conduct for providers, with a focus on consumer rights and protection.
- The initial proposal is planned to be released later this year.

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Our study focused on Payments, Lending, Insurance and Investments EmFi use cases

Payments

- **Embedded payments** enables consumers to connect and save payment for later use.
- Prior to embedded payments, when checking out goods on an ecommerce website or app, consumers would have to manually capture their card details.
- This was a friction point that could cause consumers to abandon a purchase should they have problems with their card.
- With the invention of embedded payments, the payment process was simplified as no physical card is required.

Lending

- **Embedded lending** enables companies to offer credit to consumers at the point of sale.
- Prior to the embedded finance, consumers needing to borrow money had to either use their credit cards or acquire an unsecured loan both of which carry high-interest rates.
- Embedded finance has enabled companies to offer credit to consumers at the point of sale.

Insurance

- **Embedded insurance** is the integration and sale of insurance when consumers purchase products or services.
- The insurance could either be complementary or consumers may need to pay a nominal fee above the transaction cost.
- Insurance on checkout in-store has been around for some time, but the financial API technology has enabled its integration on ecommerce websites and spread on additional products.
- In most instances, it is offered where and when consumers require it, with no need to exit the platform to engage with an insurance company.

Investments

- **Embedded investment** enables businesses to offer consumers access to investment products and services through a non-native financial services company's application.
- This enables platforms to provide investment services to their customers together with other services like payments.
- The most common use case of investment allows companies to integrate investments like equities, unit trust or bonds (equity trading capabilities) within their product offering.

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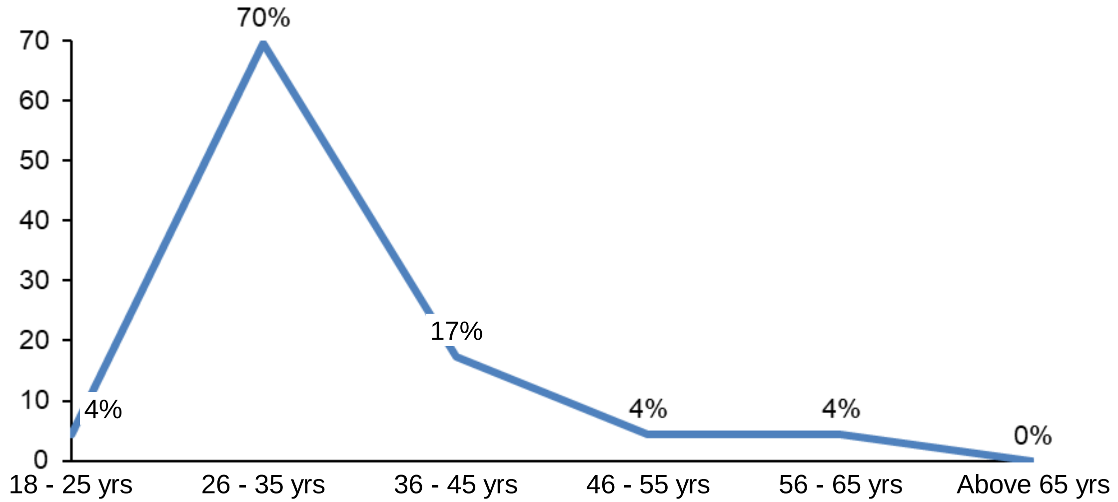
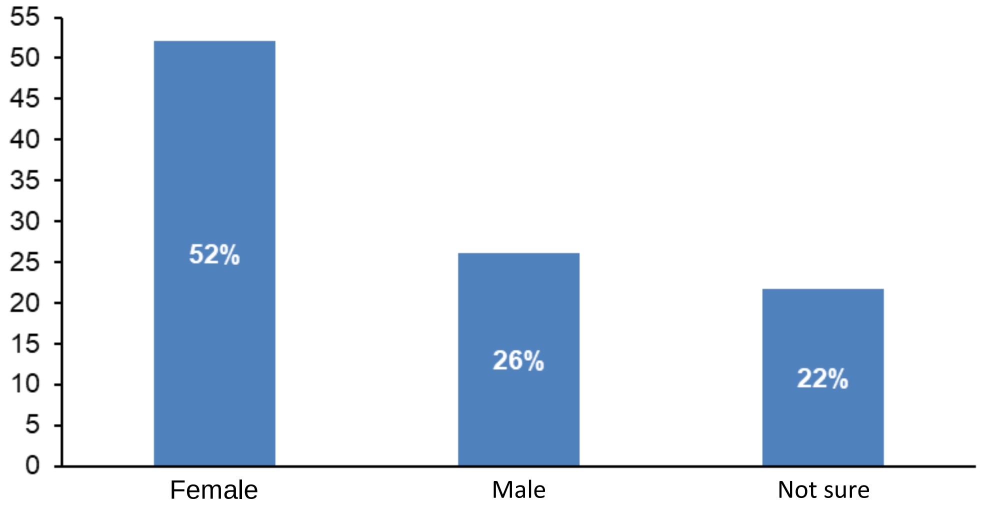
Millennials are the dominant users of EmFi

Dominant age group



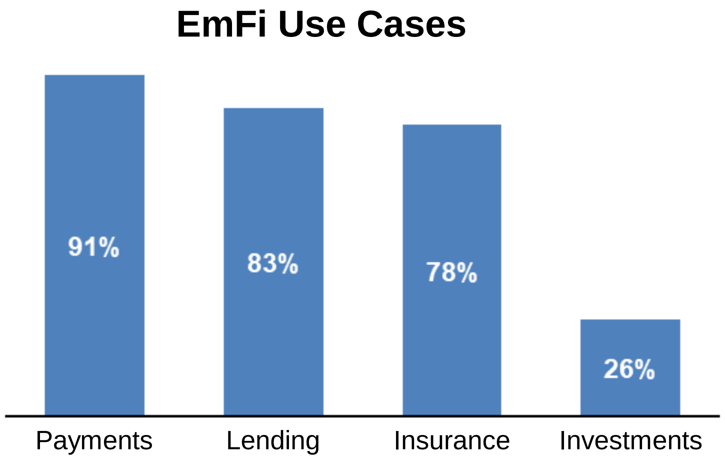
Dominant gender

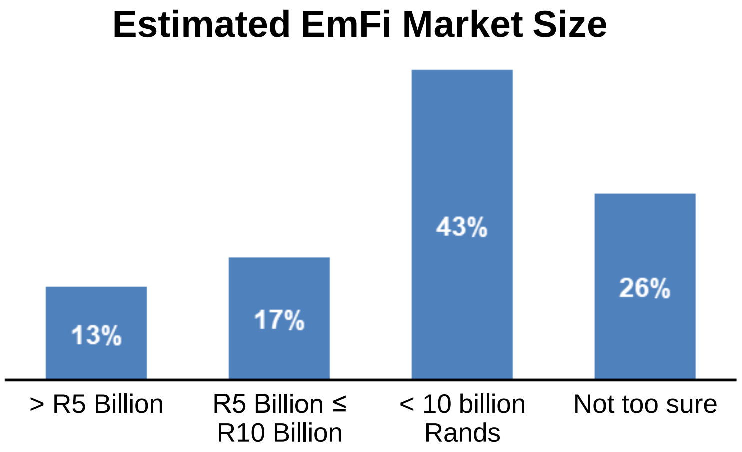


- The dominant age is the 26 to 35 years followed by the 36 to 45 years.
- This is attributed to the high mobile internet user penetration within that age group.
- There is also high demand for financial products and service and millennials have the means to access financial solutions.
- This age group is also more willing to take risks and try new things.

- The dominant gender using embedded finance is female.
- The results are attributed to most providers targeting women.
- First time male users are mostly because of curiosity.

Payments is the dominant use cases amongst the 4 EmFi use cases considered

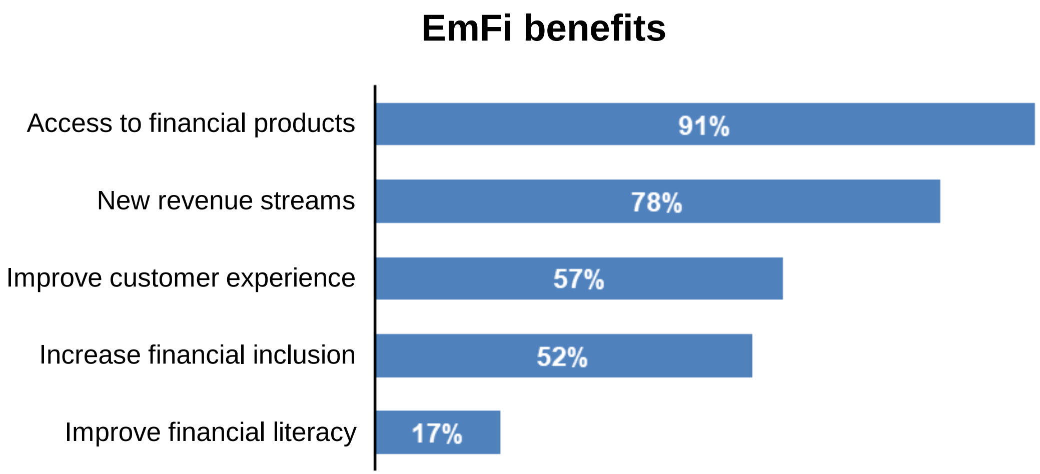




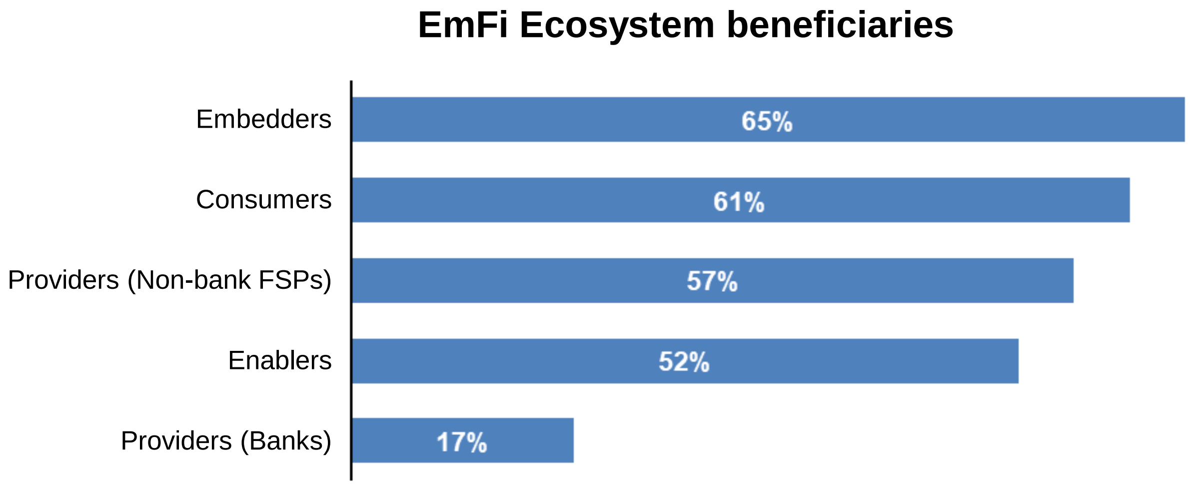
- Payments is the dominant use case followed by Lending and Insurance.
- It is a gateway into the financial system given the need for businesses and consumers to transact everyday.
- Over 70% of operating fintech companies and start-ups are in the payment space resulting in the availability of more payment solutions.
- Investments are considered to have strict regulatory requirement which may hinder participants.
- The current economic conditions and the high cost of living contribute to the low investment appetite by consumers.

- The survey findings suggests that the EmFi market size is more than 10 billion Rands.
- Judging from the number entrances into the space, there are more EmFi opportunities which are yet to materialise and explored.
- EmFi has a multiplier effect which allows for the integration of other embedded finance solutions.

Increasing easy access to financial products is the top EmFi benefits

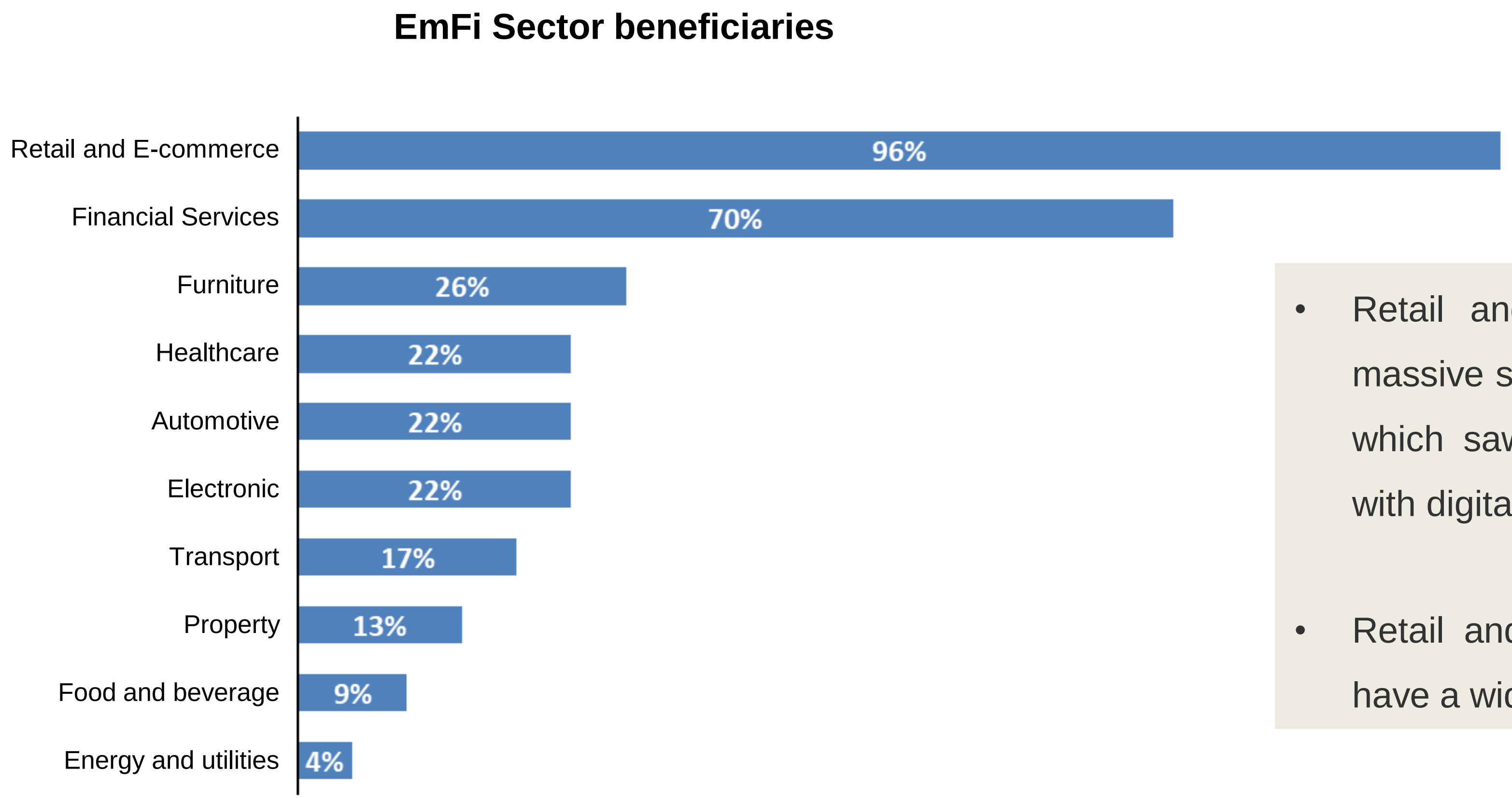


- Access to financial products followed by generating new revenue streams (78%) and improving customer experience (56%) were noted as the top 3 EmFi benefits.
- EmFi is associated with new players who are challenging the traditional banking channels with relaxed KYC requirements allowing consumers to have easy access to products.



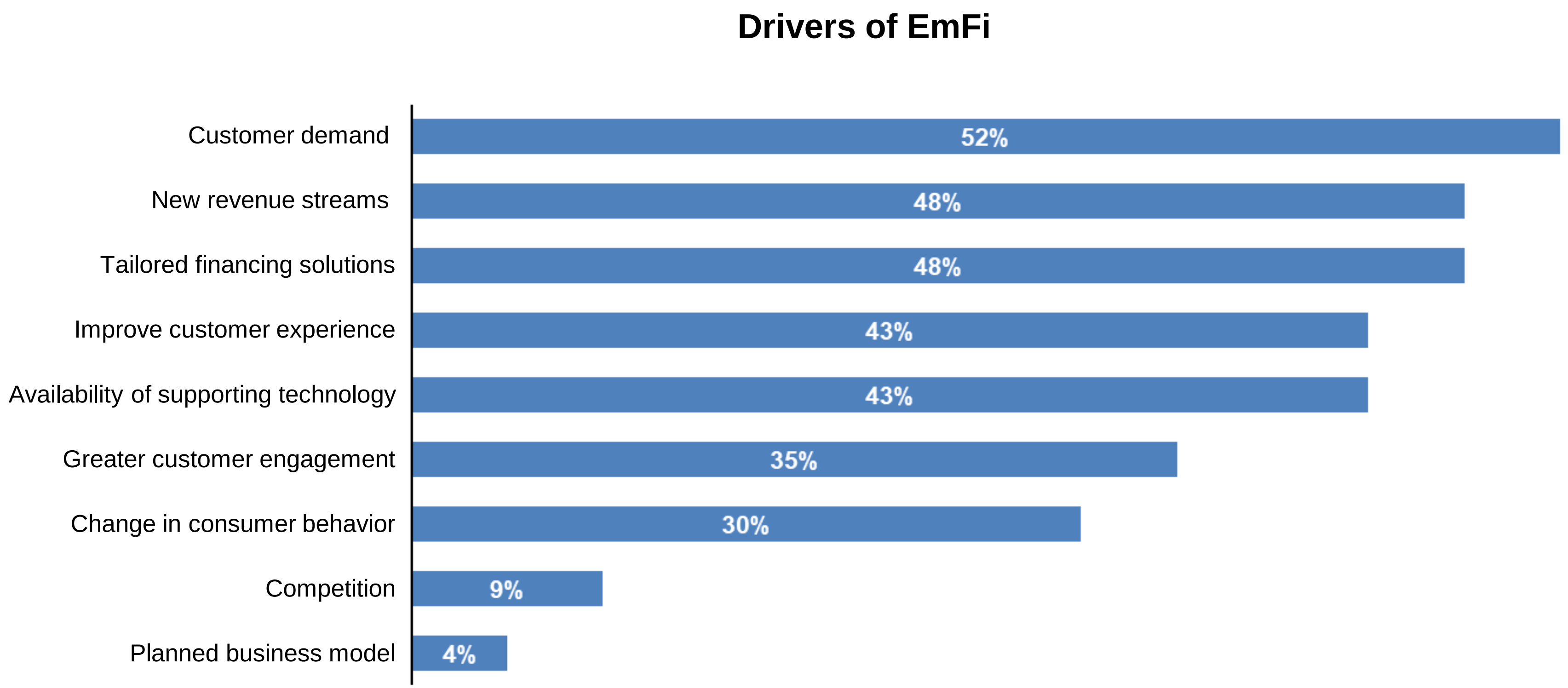
- Embedders and consumers are considered to benefit the most from embedded finance.
- Embedders are benefiting from the improved customer experience which drives conversions and provides new revenue streams.
- Consumers are gaining from the easy access to financial products as a result of the relaxed KYC.

Retail and E-Commerce sector is gaining the most from EmFi



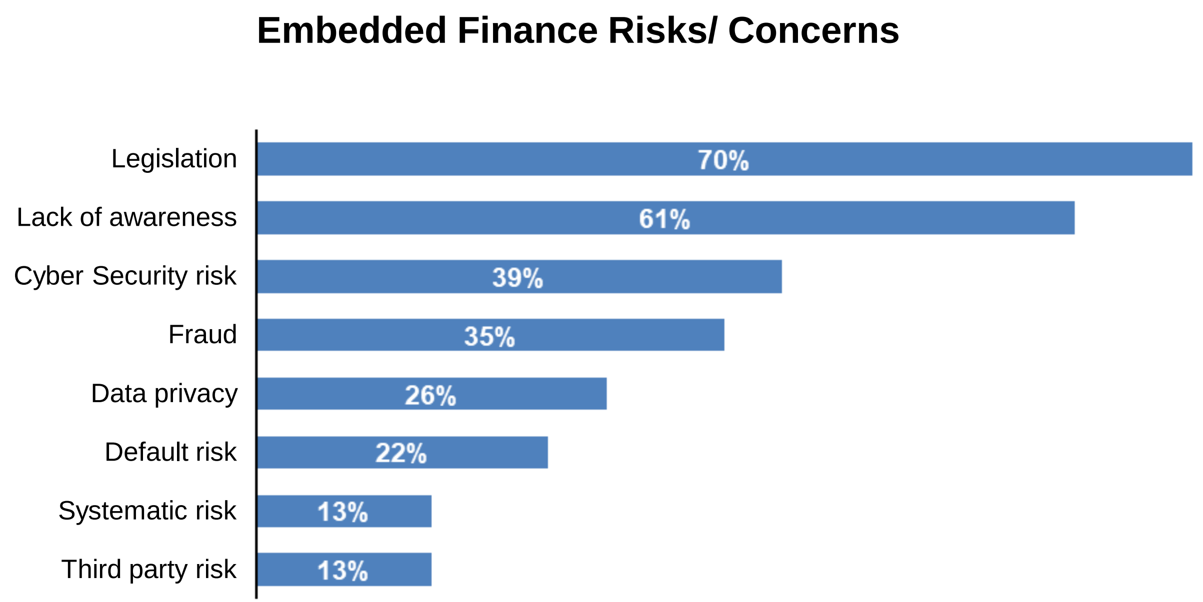
- Retail and E-commerce sector experienced a massive spike during Covid19 induced lockdowns which saw consumers gaining more confidence with digital platforms.
- Retail and E-commerce belongs to brands that have a wider footprint

Increasing customer demand for financial services is the top factor driving EmFi



- The statistics depicts that customer demand, need to accelerate new revenue streams for growth and the need to offer more tailored financial solutions to customers (48%) are the key factors driving the adoption of embedded finance.

Lack of enabling legislation was identified as the key EmFi risk



- The top three EmFi concerns identified from the survey were lack of enabling legislation (70%), lack of awareness (61%) and cyber security risk 40%.
- Some of the legislation is considered to have been written before EmFi and as such in some instances it is restrictive or not clear.
- There is an imbalance between fintech innovations and legislation developments.

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Five key Implications for the Financial Sector (1/2)

1

Regulatory framework

The idea of EmFi existed for many years, but it was not given much regulatory attention. The nonexistence of specific regulation creates uncertainties for instance, about the responsible party for regulatory violations.

- Regulators may need to establish bespoke regulation governing specific areas of EmFi such as BNPL.

2

Complex commercial relationship and third-party risk

EmFi enables consumers to engage with products and services from two or more separate institutions. This can create a problem for consumers because they may not know which institution is responsible for which part of the product service or purchase experience.

- Improve third-party governance by implementing an integrated risk management strategy designed to catalog, assess, evaluate, treat and monitor third-party risk, prioritizing areas where there is external access to internal systems and customer channels.

3

Data privacy & Cyber Security

Financial institutions and the EmFi partners should also ensure that data transfer arrangements through APIs satisfy legal and regulatory requirements

- Policy makers and regulators should constantly review the existing EmFi infrastructure, particularly, API security, data sharing arrangements and the design of embedded products and services to ensure that they comply with existing consumer protection and data privacy laws and regulations.

Five key Implications for the Financial Sector (2/2)

4 **Fraud risk**	**Full implementation of EmFi services may require relaxation of Anti Money Laundering (AML) and Know Your Customer (KYC) regulations which can expose businesses to fraud risk** • Regulators may need to provide regulatory guidance.
5 **Lack of awareness**	**Improving financial literacy by leveraging digital platforms to provide information and training and incorporating insights from behavioral economics such as nudges and reminders or the use of entertainment** • Improving financial literacy can increase consumers awareness in EmFi, increasing their knowledge for the products, services, and providers resulting in them escaping any form of exploitation and abuse.

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