FED Seminar on ePayments and Financial Inclusion

Trade and Regulatory Frameworks for Digital Financial Services

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Access to financial services and ICT is recognised in SDGs

• Goal 1 - ending poverty: 1.4 (...) ensure that all men and women (...) have access (...) to basic services, (...) new technology and financial services (...);

• Goal 2 - ending hunger: 2.3 (...) double the agricultural productivity and incomes (...) through secure and equal access to (...) financial services (...);

• Goal 5 - achieve gender equality: 5.a Undertake reforms to give women (...) access to (...) financial services (...).

• Goal 8 - economic growth and employment: 8.3 (...) support productive activities, decent job creation (...) including through access to financial services; 8.10 Strengthen the capacity of domestic financial institutions to encourage and expand access to banking, insurance and financial services for all;

• Goal 9 - infrastructure, industrialization and innovation: 9.2 Increase the access (...), in particular in developing countries, to financial services (...); 9.c (...) increase access to ICT and (...) universal and affordable access to the Internet (...);

• Goal 10 - reduce inequality: 10.5 Improve the regulation and monitoring of global financial markets and institutions and strengthen the implementation of such regulations; 10.c (...) reduce to less than 3 per cent the transition costs of migrant remittances and eliminate remittance corridors with costs higher than 5 per cent.

• Goal 17 - means of implementation: 17.14 Enhance policy coherence (...); 178 (...) enhance the use of (...) ICT.
Financial inclusion is key for income and welfare opportunities:

- Financial services play an important multidimensional role:
  - Encompass activities with high value added and qualified jobs;
  - Provide inputs for all economic sectors & individuals: facilitate transactions; mobilize savings; insure & reduce risks; allow credit for productive investments in the real economy; facilitate trade (e.g. letters of credit, insurances);

- Financial inclusion, the “effective access and use by individuals and firms of financial services from formal providers” contributes to poverty reduction, and economic and social development:
  - Basic payment, savings and insurance services benefit the poor;
  - Addresses development inequalities for firms: in developing countries only 34% of firms have a bank loan (51% in developed countries) and informal firms (80% of MSMEs) face major challenges in financial access;
  - Maximizes the developmental impact of remittances by formalizing their flows, reducing transfer costs and facilitating their investment into productive activities;

- Financial inclusion needs to consider trade in financial services:
  - Cross-border exports in financial services reached around $540 billion in 2015 with an annual growth rate of 7% for 2005-2015. Developed economies account for 84% of global exports but exports in developing countries grew faster (12%) than in developed economies (6%).
Income disparity is a global risk affected by financial exclusion:

- 83.3% of total wealth is concentrated on 8.4% of the world population.
Financial inclusion has progressed but gaps remain

- **By gender and age:** in 2014, 62% of adults had a bank account, above 50% in 2011; women are behind (more in South Asia) with 58%, above 47% in 2011; youth was also worse off (more in Europe & Central Asia) with 46%, above 37% in 2011;

- **By income level:** the share of adults in developed countries that have a bank account is much higher than that of developing countries; middle income countries have an account penetration rate that doubles the one of low income countries;

- **By region:** Asia and the Pacific exceed the global average of account penetration (including for women and youth) while MENA and Sub-Saharan Africa lagged behind.

People with a bank account by region and income level, 2014 (%)

Source: UNCTAD based on the World Bank’s Global Financial Inclusion Database

Note: adults are people over 15 years old and youth are people between 15 and 24 years old.
There is a variety of reported obstacles for financial inclusion:

- No demand for bank accounts from people across gender, age groups and geography, and firms:
  - Lack of disposable money is a main reason for having no account;
  - Exclusion for physical, economic, administrative and psychological barriers such as cost, travel distance, paperwork and lack of trust in banking system;
  - These barriers mainly affect the poor, women, youth, rural population, informal workers and migrants.

Self-reported barriers to use of formal accounts, 2011 (%)

Digital financial services play a key role in financial inclusion

- Builds on ICT to reduce infrastructure costs and increase coverage:
  - 2 billions lack a bank account but, of these, 1.6 billion access to a mobile phone;
  - Telecom and ICT services allow for more productivity, efficient and automated processes, access to information, reduced production and transaction costs;
  - Effects are enhanced when it comes to international trade where information and connectivity barriers are traditionally higher. ICT-enabled solutions allow for better connections; knowledge on the traded product and alternatives; payment solutions; and, in some cases, facilitate distribution services;

- DFS have positive externalities: incentivises use of banking services by establishing linkages; information on mobile money usage may help credit scoring;
  - Is more gender neutral and youth friendly. Allows for sectoral development (e.g. credit & insurance mobile products promote agricultural development).

Cost of infrastructure ($US) and number of points of presence (thousands) by channel of delivery

**Source:** UNCTAD based on the CGAP. Note: logarithmic scale.
DFS are not a panacea for financial inclusion

- Lessons from UNCTAD expert meeting on financial inclusion:
  - The infrastructure gap (e.g. ICT, energy) financing must be bridged:
    - The estimated annual global infrastructure investment need is about $3.7 trillion, and only a $2.7 trillion is currently met annually, resulting on a $1 trillion gap;
  - Mobile money DFS still account for a smaller value of transactions;
  - High access rates does not imply high usage: in Malawi, users are mostly interested in buying mobile airtime and cash-out is limited due to low agent liquidity;
  - Engagement between regulators/operators for increased usage:
    - Poor people without any access to technology are not financially included;
    - Solutions may not be suitable for all (women, youth, elderly, with disabilities, …);
  - Success stories may be hard to replicate:
    - Results in Kenya depend on critical mass of users/specific regulatory framework;
    - Choice of model (bank or MNO centric) relates to the country specific regulatory situation. The focus should be in enabling innovation without prescribing models;
  - Consider risks related to fragmentation of standards:
    - Fragmentation limits proliferation of technologies that require scale. Decisions on technology convergence /coexistence should attend market needs but, above all, ensure that standards do not become barriers for developing country operators.
Bulk payments through digital financial services

- Bulk payments (e.g. G2P subsidies and B2P payroll) increase digital financial inclusion;

- Development importance of digital bulk payment services:
  - Decrease leakage (money lost in cash transfer delivery could be 70-85%);
  - Improve identification, traceability, and availability of data for evaluation;
  - Reduces the logistical cost and security issues of transferring cash;
  - Increases transparency and reduces corruption risks;

- Remaining challenges specific to bulk payments:
  - Issues of moving from a cash programme: cleaning enrolment data, gathering KYC information, system integration and reconciling payment records, …;
  - Interoperability to facilitate routing and adoption by users.
Payment services in DFS

B2B payments increase digital financial inclusion

• Systemic importance for DFS and digital financial inclusion:
  – Digital liquidity, lower cost of doing business, MSMEs development/formalization;
• Allows for the participation of MSMEs, small buyers and suppliers;
  – Buyers gain more control over the timing of disbursement; eliminate the need to be physically present at delivery; build a digital history of timely payment (improving credit worthiness); increase transparency and security of payments; data on payments can be used to manage relationships, track payments, facilitate repeated payments, and allow analysis and better business decisions; facilitate accurate accounting and tax and regulatory compliance;
  – Suppliers gain faster payments; improved security; data to manage relationships, track payments; increase client base (distant and digitally-focused customers); build a digital history (improving availability of e.g. receivables financing);
• Remaining challenges specific to B2B payments:
  – Difficult adoption among companies wanting to avoid taxes and regulation, cash-starved businesses and users of post-dated checks (with ePayments, money leaves accounts faster which may lead to reduced working capital);
  – Facilitated business/credit could lead to overextension and usurious practices (with facilitated ePayments and credit processes and potentially improved credit worthiness, risk of over indebtedness may increase).
Payment services in DFS

Cross-cutting remaining challenges

- Availability and reliability of energy and ITC infrastructure services;
- Data privacy issues related to collecting and processing data;
- Fraud and security risks to payment systems;
- Lack of technological knowledge is a limitation and requires training;
- Liquidity to agents and to users that still cash-out is relevant;
- Resistance to change and bureaucracy linked to Know Your Customer (KYC) requirements;
- Sound agent networks, and interoperability remain critical;
- Proportional regulation is required to involve disadvantaged users (poor, rural areas, migrants, MSMEs, …).

- Payment services and DFS in general depend on trade and investment and on competitive and interoperable markets and thus require a sound trade and regulatory frameworks.
The enabling ecosystem for trade and to attract investment in DFS

- Developing DFS, including through investment and trade, requires:
  - An enabling environment that consists of laws and regulations; national policy and institutional frameworks; standards; regulatory and supervision institutions;
  - Infrastructure readiness that consists inter alia of energy and ICT availability; identity systems; payment systems; voice and data communication networks.

The Digital Financial Services Ecosystem

Source: Focus Group on Digital Financial Services (2016), The Digital Financial Services Ecosystem.
Digital liquidity is required for trade and investment in e-payment

- Digital liquidity (keeping money in eMoney form rather than cash), is enabled by:
  - Delivery of bulk payments (e.g. G2P, B2P) to enable adoption of digital accounts;
  - Merchant services (payment acceptors) to receive payments of digital wallets;
  - Interoperability to enable "ubiquity" to make payment to any receiver regardless of who is providing the transaction account for that receiver;
  - Additional financial services, such as savings, lending and investing;
  - Sound and competitive trade and regulatory frameworks.

Reaching Digital Liquidity

Source: Focus Group on Digital Financial Services (2016), The Digital Financial Services Ecosystem.
Trade & regulatory frameworks for DFS

Coherent regulatory frameworks to harvest the potential of DFS

• Lessons from UNCTAD's MYEM Trade, Services and Development:
  • Multiple regulatory objectives:
    – Address information asymmetry; moral hazard (indebtedness); imperfect competition (market concentration / undersupply in rural areas and to the poor);
    – Balance between efficient markets and universal, equitable & affordable access to financial services, pursuing simultaneously inclusion, stability, and integrity;
    – Allow competing providers / consumers to benefit from technological innovations;
    – Competition, consumer protection, level playing field, access to resources;
    – Diversification to reduce vulnerability to external shocks / disruption of supply;
  • Multiple levels of regulatory coherence are required:
    – Envisage synergies in otherwise competing objectives of financial stability (macroprudential objectives), financial security and financial inclusion;
    – Seek proportionality as excessive regulation may hamper financial inclusion. E.g. stringent anti-money laundering / combating the financing of terrorism (AML/CFT) requirements may create bias against low value added customers;
    – Example in the Philippines: requirements on risk management, capital, liquidity and others were applied proportionately to non bank providers. Ring fencing of e-money operations and transaction limits were applied;
    – Institutional coordination between area and sector regulators, between financial and telecommunication regulators, and between regulators of several countries;
Coherent regulatory frameworks to harvest the potential of DFS

- DFS require coherence between regulatory objectives:
  - Regulatory focus includes competition, network interoperability, innovation, licensing for a level playing field, and information security risks;
  - Interoperability should emerge as a market solution but if regulatory intervention is required, it should neither be too late to avoid entrenched monopolies nor too early to avoid deterrence of innovation and investment;
  - Example: inclusion / competition goals were balanced in regulating M-Pesa. Considering high development costs, regulators allowed a 7 year dominant position through exclusivity arrangements. The system opened to competition in 2014, reducing transaction costs from $4.91 to $0.43;

- Regulatory principles:
  - Similar regulations for similar functions; risk-based regulations; and balance between ex-ante and ex-post regulations;

- Consumer protection needs to consider the whole DFS value chain:
  - Issues include fraud, transparency with regard to conditions and fees, lack of adequate dispute resolution and alternative recourse, network downtime and security; data privacy;
  - Protection of bank trust accounts, where eMoney is backed, is important for consumers to recover money in case of bankruptcy.
Trade & regulatory frameworks for DFS

Trade and regulatory coherence for DFS

• Lessons from UNCTAD's MYEM Trade, Services and Development:
• Trade liberalization has potential and risks for DFS:
  – Trade, under right conditions, may promote supply, efficiency & competitiveness;
  – Trade dimension of effective regulation is relevant for financial inclusion, for instance through universal access requirements, particularly when there is substantial presence of foreign providers in domestic financial markets;
• Smart regulations are a precondition to trade liberalization:
  – Trade liberalization needs to be adequately coordinated, paced and sequenced with domestic regulation to promote DFS;
  – Lessons learned from recent crisis should be considered in negotiations, to determine adequate levels of policy space and regulatory/institutional framework.
• De-risking has a development impact:
  – Some financial institutions terminate or restrict services, including withdrawing correspondent banking relationships, to avoid rather than manage risk;
  – Concerns increased with more stringent anti-money laundering / combating the financing of terrorism (AML/CFT) requirements but wholesale de-risking is not consistent with the advocated risk-based approach;
  – Regulatory & supervisory authorities should enforce effective risk management.
Best practices on risk management

- Regulatory frameworks need to address challenges on:
  - Exchange controls licensing;
  - Varying anti-money laundering / combating the financing of terrorism (AML/CFT) and know your customer (KYC) requirements;
  - Central bank policies around clearing and settlement;

- Specifying KYC requirements:
  - Tiered access to avoid exclusion from undocumented (e.g. rural, migrants);
  - National identity schemes are beneficial to unbanked. Biometric components have potential to increase security and avoid payments to "ghost recipients";

- Requiring AML/CFT monitoring of suspicious activity:
  - Proportional approach is required not to discourage or impede usage from disadvantaged profiles, and not to make operational costs impeditive;
  - Effective risk management, rather than avoidance is needed (e.g. de-risking);
  - AML/CFT reporting of suspicious activity required even for lower-risk accounts;

- Agents can support the appropriate user identification/registration:
  - Agents should be properly trained and monitored to follow customer due diligence procedures upon account opening (and as required for cash-in, cash-out, payments, etc.).
Trade and regulatory coherence for DFS

- Data flows are increasingly important for DFS:
  - Flows grew 45-fold in only a decade, and might grow another nine-fold by 2021, and have had a larger impact on global growth than traditional flows of goods;

- Balance between data flows for trade and privacy objectives:
  - Policy objectives (cyber security, data privacy and protection, IPR protection) may lead to regulations such as commercial presence/localization requirements;
  - RTAs increase binding commitments but concerns remain on overly aggressive provisions. Data protection issues may be addressed by mutual recognition of consumer protection systems instead of local presence requirement;
  - Important to determine the best technological and regulatory means of ensuring policy objectives without excessive burden on trade.

Evolution of data localisation by degree of restrictiveness

*Source:* WTO, based on ECIPE, Digital Trade Estimates Database.
Main recommendations to policy makers and regulators

• Lessons learned from the ITU Focus Group on Digital Financial Services, chaired by the Gates Foundation:

• Support an open ecosystem for DFS that promotes innovation and competition;

• Should have accurate and timely information on direct and indirect prices consumers pay to access DFS and ensure market prices are not a barrier to use;

• Encourage merchants and other payment acceptors to accept ePayments;

• Encourage identity systems to help account opening, ePayments and security;

• Public support to DFS is necessary (e.g. digitization of Government services, G2P bulk payments, education and infrastructure policies);

• Leverage existing infrastructures and capabilities to avoid duplication of costs, including using postal networks to support the DFS ecosystem.
Thank You

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More information on services, trade and development:

More information on financial inclusion: