

The International Telecommunications Union (ITU) – Digital Financial Services (DFS)
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Minister’s Feature Address

***“Digital Financial Inclusion and the Impact on the Financially Excluded and Underserved...
A Policy-maker and Regulator Perspective”***

Observation of Protocol, etc.

I want to thank the ITU for inviting me to deliver the feature address at this workshop which in my view is both timely and critical to how we provide more efficient and widespread financial services in the future in the Caribbean.

Introduction

One of the key points on which people focus nowadays when they consider Digital Financial Services is that these services can be extended to deliver basic financial services to financially excluded and underserved populations. These services use innovative technologies like mobile phone enabled solutions, electronic money models and digital payment platforms, and so provide financial and other institutions with the prospect of reaching billions of new customers. Thus, banks and an expanding array of non-bank institutions have begun to offer Digital Financial Services to these financially excluded and underserved populations. These institutions have been building on the digital approaches that have been used for years by those already served by the formal financial sector. Consequently, millions of formerly excluded and underserved poor customers are moving from exclusively cash-based transactions to formal financial services such as payments, transfers, savings, credit, insurance and even securities by using a mobile (smart) phone or other digital technology to access these services.

Smart mobile devices have become an extension of human life for millions of people around the world. With a wide range of prices and specifications, people from every socioeconomic level now have access to devices that rival personal computers for power, speed and accessibility.

In many nations, mobile telecommunication development has outstripped more costly copper to fibre conversion or fibre installation; thus, these mobile devices such as cellphones and tablets have become vital forms of connection both in rural, isolated areas and in large cities.

With the widespread use of the Internet and the World Wide Web, payment for goods and services has increasingly moved online, with credit cards allowing people and merchants to exchange funds without the use of cash. Banks and other financial institutions have used the

Internet to drastically reduce the time and dangers involved in remitting money over international borders, allowing business speed and productivity to rise dramatically in the past two decades.

Mobile wallets, therefore, stand at a crucial intersection of economic development and productivity. Through a combination of the widespread distribution of mobile devices and the interconnectivity of the Internet, mobile wallets allow far more persons worldwide to be linked together in secure global trade and economic participation.

Digital Financial Inclusion, then, is evolving as the significant part of the Digital Financial Services sector that is having most impact on the financially excluded and underserved. Digital Financial Inclusion involves the deployment of cost-saving digital means to reach currently financially excluded and underserved populations with a range of financial services suited to their needs, responsibly delivered at a cost that is affordable to customers and sustainable for providers.

The Benefits of DFI

You know the benefits of digital financial inclusion. Firstly, there is the benefit of having access to formal financial services such as payments, transfers, savings credit, insurance and securities. Migration to account-based services typical expands over time as customers gain familiarity with, and trust in the Digital Transactional Platform. Government-to-person payments, such as conditional cash transfers, that can enable digital stored-value accounts, may provide a path for the financially excluded into the financial system.

The costs that Digital Transactional Platforms present to the provider and consequently to the customer are typically lower: these allow the customers to transact locally in irregular, tiny amounts thereby helping them to manage their characteristically uneven income and expenses.

Additional financial services tailored to customers' needs and financial circumstances are made possible by the payment, transfer and value storage services embedded in the Digital Transactional Platform itself, and the data generated within it.

As mobile devices and networks have gained processing power and bandwidth, the speed of operation has allowed complex instructions to be completed almost instantaneously at any time. Local funds can often be remitted and recognized in a few minutes; international fund transfers can happen in a few business days, often within one day. Such speed can be of terrific assistance during emergencies or imminent danger situations.

Mobile devices are equipped with batteries, which allow use without dependence on persistent electricity supply, often capable of being efficiently recharged/maintained using off-grid solutions such as portable solar charges and chemical batteries. This flexibility along with the relative ease of implementing mobile/satellite networks on a regional level allows the Internet to be accessed by millions of persons in rural/isolated areas. Such reach, combined with mobile payment solutions, expanded delivery solutions and online shopping platforms, has allowed many small-scale artisans in some remote/rural areas to sell local crafts to an international market, earning significant foreign exchange and improving their livelihoods.

There are reduced risks of loss, theft and other financial crimes posed by cash-based transactions, as well as the reduced costs associated with transacting in cash and using informal providers.

DFI risks

Notwithstanding the benefits, there are some risks against which adequate protection and risk management practices must be deployed. These include:

1. Retail Agent-related Risks

A retail agent functions as a third party acting on behalf of a bank, non-bank or other financial institution to deal directly with customers, under some contractual arrangement. Armed with a digital device that is connected to communications infrastructure to transmit and receive transaction details, retail agents enable customers to convert cash into electronically stored value and to transform value back into cash, electronically.

Agents and agent networks introduce new operational, financial crime and consumer risks, many of which are due to the physical distance between agents and the provider or agent network manager and the resulting challenges to effective training and oversight. Also, the new providers offering services may not be subject to the consumer protection provisions that apply to banks and other traditional financial institutions.

Operational risks include fraud, agent error, poor cash management by the agent and poor data handling. In addition to the financial crime risks of fraud and theft, agents may fail to comply with anti-money laundering and combatting the financing of terrorism rules regarding customer due diligence, handling records and reporting suspicious transactions.

This matter of the application of “know your customer (and know your customer’s customer)” rules and processes as well as those related to combating terrorist financing may have significant repercussions on the region as our countries seek to resolve the difficulties we all now face with correspondent banking relationships and derisking our financial and payment systems. Hopefully, the digital footprint left by using digital financial services will help eventually in assisting financial institutions better to know

their customers and customers' customers. But in the immediate future, that may not be the case; and so the digital financial inclusion may create some problems for us in this area. Of course, the difficulties being experienced with correspondent banking relationships may also negatively impact on cross-border digital financial transactions as such transactions encounter difficulty in being settled by foreign banks. Such a situation would slow the growth of digital financial services in the region. Agents may also act to reduce transparency or fail to handle customer data confidentially.

However, retail agents, particularly those located in low - income areas, are important since they can help drive down the delivery costs of financial services for underserved populations. Considerable effort must therefore be given to managing these risks identified.

2. The Digital Transactional Platform

Innovative digital financial services typically involve at least one bank and one non-bank in both the electronic storage and management of data and the holding of customer funds. The challenge here is the protection of the customer funds. Even if they are insured, even if they are pooled and a third party such as a Mobile Network Operator is responsible for storing and managing records of customers' account balances, there are still risks related to real-time accuracy and reconcilability of records of the failing holder of funds with the records of the entity managing the accounts.

3. Digital Technology-related Risks

The quality and reliability of digital technology affect the risks of disrupted service and lost data, including payment instructions (due to dropped messages) as well as the risk of breach of privacy and security resulting from digital transmission and storage of data. These risks are further magnified because a large number of retail agents handle customers' transactional and other data and the profile of previously excluded and underserved customers.

Regulatory and Policy Issues

Transfer and apportioning of liabilities between parties, respective parties ability to cover their potential liabilities

Whenever responsibility for a transaction changes hands, the matter of who takes liability at the time of crossover arises. Along with this comes the issue of the size of the liability for errors or omissions or failures in the transactions. Such liability could be high if it involves the loss of private and sensitive data. And, if there are questions about where the liability rests at some

points in time and if there are questions about the size of the liabilities, then further concern arises over the capacity of the enterprises involved in these transactions to cover those liabilities.

Interoperability

Interoperability is seen as an indispensable characteristic of financial and ICT infrastructures and therefore for the widespread availability of Digital Financial Services, which in turn effectively supports Digital Financial Inclusion. Whereas the widespread availability of digital solutions provides persons with access to financial services, the various systems/services must interoperate to enable persons to transfer their money to any other individual, without having to have multiple transaction accounts. This is almost similar to interconnection frameworks in the telecommunications services sector that allows customers of one carrier to seamlessly communicate with a customer on another network. The reasons are obvious: for example, removing increased and unnecessary cost of multiple accounts, removing the potential for confusion in managing multiple accounts, etc.

While we get enthused about digital financial inclusion, we must make some realistic assessments of its potential in the region. Given the emphasis on digital financial inclusion embracing those who are excluded from the formal financial systems, we need to consider How much of the Caribbean is financially excluded, and from what services and why? Let me suggest that this is an important bit of research that needs to be done to help in our assessment of how many more Caribbean residents will be brought by digital financial inclusion into the formal financial systems.

Another area of concern in the region in respect of financial services is the extent to which some people are not well served by the existing financial services systems. In assessing the value of digital financial inclusion in the region, we must therefore also ask “How much of the region is financially underserved and in what areas?” This is important if the offerings in digital financial inclusion are going to improve and expand the level of services provided to those who are currently underserved.

A third area for the growth of digital financial inclusion is the low costs of the digital transactions. Often, we hear of the high fees charged by financial institutions in the Caribbean and one is driven to ask why the costs of financial transactions seem so high? One is also driven to ask if the factors underpinning digital financial inclusion will really reduce the cost of doing financial inclusion in the region. One must also ask “Who does this high cost of financial transactions cause to be excluded or underserved? And “How much do these costs increase the overall cost of doing business in the region, particularly for small and micro enterprises?”

A fourth area for attention in the Caribbean is the ability of medium sized, small and micro enterprises in this region to use the digital financial infrastructure to sell their goods and services

all around the world. The technology of digital financial inclusion seems to provide the opportunity for such businesses to use digital payment and ordering systems to ply their trade. But one still hears of difficulties of such businesses obtaining merchant accounts on terms that they can afford because banks still seem to feel that the risks and costs associated with merchant accounts for these types of businesses require banks to provide these accounts only at great cost and high collateral levels. Connected with this area of attention is the logistics business in the region for fulfilling and distributing orders placed over the Internet: I do not know whether our businesses are generally in position to make sure that they are able to meet these obligations.

Implications for use of foreign exchange in small open foreign exchange constrained economies

All our economies in this region are small, open economies with constraints of foreign exchange reserves. Much of the financial value of transactions over the digital transactions platforms may involve the use of foreign exchange reserves. There will therefore have to be some process of reconciling how what may be an increase in the demand and use of scarce foreign exchange reserves becomes consistent with maintaining adequate levels of foreign exchange unless the digital transactions platforms and the supporting structures lead to increases in foreign exchange earnings.

Implications for productivity and doing business in economies with difficulties in doing business and with productivity growth

One benefit for our economies that may not have been deliberately studied or promoted is the impact of the digital financial inclusion on productivity in our economies. All our countries in the region are trying to increase our productivity. The ability and propensity of our residents to do their financial and other transactions whenever they wish and wherever is convenient for them seems propitious for the improvement in productivity and service levels in our countries. When these transactions are done without persons having to leave their work and without having to spend time in moving to the places where the transactions would normally take place, everyone wins: the individual, the enterprise where the individual works and the country. I suspect that the loss of benefit by those who profit from having to provide the logistics to move persons around is far less than the gain in productivity to the country.

Implications for remittances from abroad

I do not know but it seems to me that the digital financial inclusion systems should make it easier for Caribbean residents to get remittances sent to them from family and friends outside the region and from other Caribbean countries. Remittances from abroad constitute a significant inflow of foreign exchange into all Caribbean economies and a reduction in costs of making and receiving these remittances would redound to the benefit of our Caribbean residents. This benefit would then translate into greater spending in the local economies as well as more foreign exchange reserves for our countries.

Implications for the way governments do business with citizens

The matter of increasing productivity brings to attention that of improving the way in which the governmental apparatus interacts with ordinary residents in our country. Quite apart from government to citizen payments, one would expect that the digital financial inclusion platform would provide greater efficiency in payments by residents to the government in all areas. One would also be moved to expect that the same platform would enable more “conversation” between individuals and government departments on a wide array of business that people have to conduct with government.

Ubiquity of high capacity and highly consistent and affordable broadband

To enable the continued growth of digital financial inclusion, the capacity of the telecommunications infrastructure has to be sufficiently large, be available everywhere, grow fast enough, be always consistent in its quality everywhere and be provided in cost packages that make it affordable to everyone who needs to use it. This will be a particular area of concern for policy makers and regulators.

At this juncture, I should recognize and complement the ITU Focus Group on Digital Financial Services. For the fine work it is doing. In fact, I am told that this ITU Focus Group has developed some 85 policy recommendations and 28 supporting thematic reports. And of importance to us, the ITU has developed a practical toolkit that can be adapted to local needs. I note with interest that some of the core suggestions include the following.

- Policymakers and regulators should support the growth of an open ecosystem for DFS that promotes innovation and ensures robust competition
- Regulators should standardize definitions of fraud types and require standardized, electronic and timely fraud reporting from providers
- Access criteria for interoperability schemes should be clear, objective, publicly disclosed and allow new participants, banks and authorized /regulated non-banks to join
- Policymakers should promote initiatives and incentives that encourage merchants and other payment acceptors (e.g. utilities, farmers, government entities) to accept electronic payments
- Regulators should standardize digital identity registration, and ensure interoperability between DFS operators and service providers relying on digital identity

- DFS operators should build in customer privacy measures, compliant with current or anticipated national legislation

I would like to recommend that you get hold of the toolkit in this area, if you haven't already done so, and let us get together: the ITU, UNECLAC, the CTU, the various bankers' associations, the central bankers, the anti money laundering regulators, the DFS technology providers, the cyber security experts and the consumer protection officials to see how we as a region can develop our regional DFS sector. Digital financial services through the attributes of digital financial inclusion have significant potential to provide a range of affordable, convenient and secure banking services to the poor people, small and micro enterprises in the region. But we must proceed with the care that these services demand of us.