ASIA-PACIFIC

FINANCIAL INCLUSION FORUM

Emerging Priorities in the COVID-19 Era

Proposed Actions for Policymakers and Regulators

INTRODUCTION

The Asia-Pacific Financial Inclusion Forum (APFIF) is a policy initiative established in 2010 under the APEC Finance Ministers' Process, housed within the APEC Business Advisory Council (ABAC). The primary purpose of the Forum is to identify concrete actions policymakers and regulators can take to expand the reach of financial services to the underserved. The annual APFIF Policy Dialogue provides a platform for policymakers, regulators, development experts and industry leaders to take an active role in validating and refining the proposed actions developed through the APFIF initiative and achieve consensus for effective pathways for progress.

A distinctive feature of the Forum is its broad view of financial inclusion as an enabler of inclusive growth and development in all its manifestations – financial, economic and social - and its strong focus on those at the base of the economy and the potential for financial inclusion to have a positive impact on the poor.

In 2021, APFIF adopted the theme "*Emerging Priorities in the COVID-19 Era*" and progressed the development of proposed actions for financial inclusion within two core topics:

- Facilitating recovery and resilience through financial inclusion
- Emerging financial inclusion challenges and opportunities in a world disrupted by COVID-19

These topics were discussed at the 11th annual APFIF policy dialogue which was held on 25 May 2021 and attended by senior government officials representing 18 economies as well as nearly 30 policy and industry experts. This report provides a summary of the proposed actions developed for APEC's policymakers and regulators through this dialogue. A more detailed report will be published later in the year and shared with APEC stakeholders.

APFIF is led by the Asian Development Bank (ADB) with support from the Asian Development Bank Institute (ADBI) and the Foundation for Development Cooperation (FDC).

FACILITATING RECOVERY AND RESILIENCE THROUGH FINANCIAL INCLUSION

The economic impact of the COVID-19 pandemic has been significant, especially for the most vulnerable and disadvantaged groups, including informal workers and women. The crisis has also had a significant impact on global fintech markets, with lockdowns and other movement restrictions creating unprecedented demand for digital financial products and services, leading to rapid digitization of payments and accelerated risks. With the road to recovery likely to be long and challenging, innovative approaches to financial inclusion will be needed to successfully rebuild livelihoods and increase resilience at the base of the economy.

Proposed Action 1: Support the capacity of microfinance providers to adopt digital technology to drive financial inclusion and bring the benefits of the digital economy to their clients.

Digital transformation has the potential to increase income and wealth inequality by widening the digital divide between those who have access to, and are capable of using, digital technology and those without. Traditionally, microfinance providers have played an important role in providing financial services to those at the base of the economy, including informal sector workers and micro, small and medium-sized enterprises (MSMEs). Leveraging the reach and levels of trust they often enjoy with their clients, there is an opportunity for microfinance providers to adopt digital technology in ways that can improve their operations as well as enhancing the services offered to their clients, particularly during the COVID-19 pandemic. Specific actions governments might take to facilitate this include:

- ***Promote and ensure equitable access to digital infrastructure***. Steps need to be taken to close the digital divide for all participants in the ecosystem and expand investment in digital infrastructure. For example, data connectivity remains a significant challenge across the region, especially in rural areas where many microfinance providers operate. Furthermore, use of domestic payment systems is often limited among non-bank financial institutions, including many microfinance providers. In this respect, interoperability and reach are key. Enabling access with appropriate risk mitigation measures can provide a more competitive environment, facilitate interoperability and enable greater efficiencies.
- ***Develop and promote a fully functioning digital identity system.*** Digital financial services are strongly anchored to the need for digital identity. Lack of formally recognized identification limits participation in the digital economy. If designed and implemented properly, digital identification (both for individuals and corporates) can facilitate unlocking of economic value, close the financial inclusion gap, minimize risks such as fraud and over indebtedness. It can further help microfinance providers and other intermediaries carry out customer due diligence requirements efficiently, reducing the cost of customer acquisition, which not only supports inclusion but also innovation and competition.
- ***Develop enabling policy and enhance regulation for new technologies in close coordination with other government agencies that also support innovation and technology*. ** Policies and regulations on data privacy and protection, data sovereignty, digital identity, harmonized wallet and prepaid SIM registration or cybersecurity all enable digital finance technologies but do not necessarily sit under the remit of the financial regulator.

Proposed Action 2: Prioritize investments in open digital ecosystems that accelerates responsible digitization of payments leading to inclusive recovery, resilience, and financial inclusion.

Financial inclusion priorities should focus on developing solutions for providing immediate relief (i.e. digital social payments) which can create choices and ease of access for the poor, creating opportunity (i.e. income generation) to support growth and building resilience for future shocks. To develop a secure and competitive digital financial ecosystem, governments can consider a range of key factors including data privacy, cyber security, digital identification, fair competition, physical infrastructure, connectivity, interoperability, and financial and digital literacy. Due to the sheer volume of cash transfers that pass through the growing digital payments infrastructure, getting it right for everyone is of crucial importance for governments. Secondly, emerging areas of data privacy, digital governance, consent frameworks are nascent and complex but essential for building trust and adoption leading to greater financial inclusion. Specific actions governments might take to achieve this include:

- ***Support the development of responsible digital ecosystems***. Through investments in platform design, architecture and technical support governments and their regulatory authorities can play a significant role in framing the development of the digital ecosystems of their economy. Due to the ongoing impact of COVID-19, particular importance should be placed on expediting regulatory measures which will reduce systemic exclusion of the most vulnerable from access to and usage of a diverse range of financial services.
- ***Facilitate the creation and implementation of good governance***. Governments should take a proactive regulatory approach to address both new risks, as well as the amplification of existing risks (i.e. potential for increased occurrences of fraud incidents), arising from increased digital financial transfers adoption. This can include establishing, and providing adequate supervision for, appropriate technology rules and processes to mitigate potential risks (i.e. legislation that

encapsulates consumer protection frameworks such as cybersecurity and data protection laws).

- ***Support the growth of a vibrant technology community***. This should include open-source technology start-ups as well as civil-society stakeholders which play an important role as stewards of user's experiences.

Proposed Action 3: Support innovation as part of COVID-19 recovery strategies

COVID-19 has highlighted the key role that digital finance can play in building resilience in a crisis. However, in many ways the use of digital technology to support resiliency among the poor has been less successful in economies lacking key enablers such as robust digital identity schemes, widespread account access and interoperable payment systems. For digital technology to have a meaningful impact on the region's most vulnerable populations, greater innovation is needed to develop new approaches and business models. Specific actions governments can take to establish a suitable foundation for business development and innovation include:

- ***Build the infrastructure of digital finance.*** This should be based upon ensuring digital access (i.e. mobile or internet) to as much of the population as possible. From this foundation, governments should focus on achieving the needed combination of sovereign digital identification, simplified account opening and systems to be able to use networked Golden Source data (i.e. digitization of definitive or official data sources) enabled with open access and interoperable payments systems. The combination of these elements is essential and forms an ecosystem that provides for other important developments including digitization of government payments or services (which has been crucial during the COVID-19 pandemic).
- ***Design appropriate regulatory approaches.*** These approaches should be risk-based, tiered and proportional to ensure that as risk increases, so too does relevant regulation and supervision. The use of technology can also provide important means to increase regulation and supervision efficiency. Regulatory technologies, or 'Regtech', can facilitate meeting monitoring, reporting, and compliance requirements effectively and efficiently, while 'Suptech' relates to how supervisors leverage technological advancements, e.g. through digitization of data or the and the automation of reporting and data collection by supervisors.
- ***Provide support for the wider data ecosystem***. Core to this is a framework around how data is collected and used. It is becoming of greater importance to governments as digital transformation accelerates is how to build frameworks that will enable, in the most effective way, use of data across society to support development while also minimizing associated risks. To address this, governments should provide direct support to needed research and development including establishing innovation hubs and regulatory sandboxes.

EMERGING FINANCIAL INCLUSION CHALLENGES AND OPPORTUNITIES IN A WORLD DISRUPTED BY COVID-19

As technology developments continue to accelerate in response to the COVID-19 pandemic, governments need to consider how these developments are now shaping a post-COVID-19 world. The expansion of digital services during the pandemic will put increased pressure on policymakers and regulators to ensure that these developments lead to greater inclusion and prosperity for those at the base of the economy, including the development of safe and reliable fintech markets and other emerging opportunities to accelerate progress.

Proposed Action 4: Reassess financial inclusion strategies to consider the growing use of digital financial services.

The fast-moving pace of technology and fintech developments, including new innovative digital products and services being introduced into the market, continues to accelerate because of the

COVID-19 pandemic. While studies have shown that higher levels of financial inclusion positively impact aspects such as poverty, income inequality, women's empowerment or entrepreneurship, the acceleration of technology in financial markets are rapidly changing the financial inclusion landscape. To ensure that financial inclusion strategies have the greatest impact on socioeconomic outcomes, governments need to reassess their strategies and ensure that they continue to align with this changing environment shaped by an increasingly digital world. Specific examples of actions governments can take to achieve this include:

- ***Reassess financial inclusion strategies within the context of a digital transformation roadmap***. As the growth and development of digital financial services continues to expand, alignment between financial inclusion and digital transformation strategies will become more important. Such alignment will help ensure that concrete actions can be implemented in a consistent manner and promote greater collaboration among a wider set of stakeholders to achieve scale.
- ***Consider new dimensions of financial inclusion.*** Financial inclusion is a complex phenomenon linked to multiple underlying factors and evolving conditions. Apart from traditional supply (access) and demand (usage) dimensions, fintech infrastructure and financial development (i.e. ease of getting credit, bank concentration, financial system deposits to GDP, and depth of credit information) should also be considered as they also contribute to financial inclusion.
- ***Recognize that the impact of financial inclusion varies depending on the economy's state of development***. Economy income levels are suggestive of the level of income and non-income development of individual economies. The varying significance and impacts of financial inclusion and its multiple dimensions across income groups suggest such economy characteristics need to be considered in developing effective policies to promote financial inclusion as part of economy-wide development strategies.
- ***Prioritize financial inclusion policies that will have a greater effect on socioeconomic outcomes***. The impact of financial inclusion and its dimensions (i.e. access, usage, financial development and fintech infrastructure) is not universal across all economies. Some aspects of financial inclusion may be more important than others in achieving positive socioeconomic outcomes depending on economy specific situations proxied by different income levels. When assessing these priorities, governments should ensure that adequate attention is paid to demand-side factors. For example, digital finance literacy programs targeting all sectors can play an important role in improving trust and confidence in the digital finance ecosystem and drive greater usage and impact.

Proposed Action 5: Take steps to promote greater stakeholder cooperation to progress digital financial inclusion at the base of the economy.

While the fintech sector continues to expand due to the COVID-19 pandemic, most financial institutions are still unable to serve their customers digitally; particularly at the lower ends of the market where many people remain financially excluded. Furthermore, very few fintechs or traditional financial institutions are focused on providing digital services to the lower ends of the market despite significant potential for business growth opportunities due to persistent challenges such as high levels of illiteracy, reliance on cash or limited access to digital infrastructure. As the usability of technology continuously improves, governments can play a key role in supporting greater cooperation between fintechs and financial institutions to enable more people at the base of the economy to receive, and benefit from, digital services. Some specific actions governments may consider to help facilitate this include:

- ***Re-imagine regulatory technology risk management frameworks***. Many of the frameworks currently in use are based on older technology which was more complex and difficult to integrate than what is used today. Appropriate processes should be adopted, promoting de-risking in the digitization process more efficiently by bringing together multiple fintechs to support rapid prototyping and identifying those that meet the needs most effectively.

- ***Fast-track regulatory licensing process for microfinance providers going digital***. An important aspect in achieving this would be for regulators to recognize existing frameworks that microfinance providers might leverage rather than treating each digital journey as a stand-alone, unique case. Furthermore, governments can provide standard, open Application Program Interfaces (APIs) to streamline regulatory reporting requirements.
- ***Establish legislation with clear timelines for fully open banking API's for in-country incumbent players***. For example, national or international payment gateways, tier-1 banks, credit bureaus, etc., are not often able to acquire API definitions easily. By publishing all APIs as open APIs it will support greater integration and connectivity within the financial ecosystem. This will help level the playing field for smaller microfinance providers and local /global fintechs and speed up digitization. Since the enactment of legislation is often a long process for most economies, governments might consider the adoption of an economy-wide framework in the short-term.

Proposed Action 6: Explore the potential of innovative fintech financing mechanisms for digital infrastructure development needs.

Addressing the financing gaps for digital infrastructure development is a significant challenge for many governments, especially in developing economies with less developed capital markets. However, addressing these gaps and enabling the development of safe, reliable, and affordable digital infrastructure is critical to achieving digital financial inclusion. As technology continues to develop at a rapid pace, emerging fintech models such as asset tokenization, blockchain-based project bonds or crowdfunding provide potential innovative solutions for raising capital. Specific actions governments could take to explore and enable these innovations further include:

- ***Identify and invest in key digital systems***. To harness the potential of innovative fintech solutions to help generate investment capital, certain digital systems need to be in place such as crowdfunding platforms, mobile banking or tokenization of debt/equity instruments. Governments should consider priorities for enabling fintech to develop viable solutions for mobilizing domestic savings and scaling up sustainable investment opportunities.
- ***Nurture relevant talent to enhance internal capabilities***. This might include placement of technology experts within central banks or other government ministries as well as establishing a dedicated core technology innovation group or an expert network to provide several functions such as identifying potential innovative models and use cases, facilitating public-private collaboration or coordination with international partners.
- ***Explore different innovative fintech solutions to mobilize domestic savings.*** To fill the digital infrastructure financing gap, financial authorities should take a proactive approach to identifying what fintech solutions may be most effective in facilitating domestic resource mobilization and contribute to financial inclusion. Furthermore, they also need to create adequate regulatory frameworks that allow for the development of promising fintech solutions while safeguarding financial stability and consumer protection. The most appropriate solutions will vary between economies dependent on local circumstances. Greater international cooperation to share lessons and best practice would support efforts.