Muhammad bin Ibrahim: Innovative financial inclusion

Opening remarks by Mr Muhammad bin Ibrahim, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Global Symposium on Innovative Financial Inclusion, Kuala Lumpur, 21 September 2016.

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While the global economy is still recovering from the Global Financial Crisis, the focus on boosting global growth has never eclipsed the financial inclusion agenda. In fact, policymakers continue to recognise the importance of financial inclusion and have accorded it as a global priority to address the widening income inequality gap, to promote the economic empowerment and protection of low income households and SMEs and to unlock the growth potential of the fast-expanding middle class population. Expanded opportunities to save securely, to invest in productive activities and to protect against unforeseen shocks, would meet the needs of the underserved. This would drive domestic demand, a key engine of growth for many economies. Between 2011 and 2014, the World Bank estimates that 500 million people have gained access to formal financial services for the first time. If our efforts continue, we are on our way to assisting the remaining 2 billion adults that remain financially excluded.

A succession of technology breakthroughs combined with the ubiquity of mobile devices present significant opportunities to scale up financial inclusion to an unprecedented level.

Beyond the socio-economic demands, there is a moral obligation for us to do more to help the millions who are still living in abject poverty and highly vulnerable to financial hardship, with no means to change their circumstances.

This global symposium presents an opportunity for us to explore solutions from different perspectives.

I see this as having "an eye for innovation". Indeed policy makers are now improving their capabilities in technology and innovation, recruiting talent, establishing dedicated team and intensifying partnership with the private sector, to help them see things a little differently. While there is no shortage of ideas on new and innovative ways to increase financial inclusion, the key challenge to my mind is the ability to scale up and achieve sustainability.

The symposium's theme refers to "harnessing innovation", but one needs to truly understand innovation in order to successfully tap on such innovation to attain the dual objectives of scale and sustainability in inclusive finance.

With that in view, my remarks this morning will focus on three areas where an eye for innovation is needed:

a. First, putting on a new lens to spot the opportunities from existing innovations that can be tailored to financial inclusion;

b. Second, identifying and working on our blind spots by driving efficiency gains with technology-enabled financial inclusion; and

c. Third, having a clear picture of the policymakers' role in promoting an enabling environment for financial innovation and technology.

Putting on a new lens: Exploiting mainstream innovations with a financial inclusion focus

Today, financial innovations have penetrated, and continue to permeate almost every aspect of financial activity. This has been driven by faster computing speed, lower cost of storage and faster problem-solving capabilities.

Technology is being used by financial institutions to improve operations – from improving customer experience to constructing better models to manage risks more efficiently and effectively. In many cases, strategic partnerships with fintech companies have been established to achieve similar outcomes. The advent of robo-advisers and algorithmic underwriting are some of the examples.

These developments have largely evolved within the mainstream customer segments and have proven to be effective. Clearly, opportunities exist to leverage on capabilities that are already in place to create specific applications for financial inclusion. With proven application, the prospects for achieving greater scalability, faster time to market and increased take-up are correspondingly greater.

For years, financial institutions have invested heavily in technology that has helped improve the collection and mining of financial and non-financial data to gain richer insights into customer preferences and behaviours. These same capabilities create immediate opportunities to identify specific barriers to financial inclusion for different target groups whose needs are shaped by very different priorities, experiences, values and norms. For example, cultural biases can be an important factor that is not fully appreciated and understood as a factor that limits higher levels of financial inclusion among women. Among lower income groups, a more granular level of analysis on income patterns is needed to structure solutions that address the irregularity in loan repayments.

Financial inclusion for the ageing population is another critical area that requires more understanding. It is important that new products, delivery channels and technologies also work well for our senior citizens that are financially excluded. Many financial products and services offered today have age limits that create barriers to access financial services. This ought to be changed to ensure inclusive financial systems for the ageing population segment. Technologies that enable better data collection and analytics can support deeper research to fill this gap while mitigating the risks to providers of financial solutions.

Beyond data applications, opportunities exist in other areas. For example, distributed ledger technology eliminates the need for centralised transaction validation and shortens the settlement chain, effectively lowering costs of real-time remittances. By incorporating adequate Know-Your-Customer (KYC) requirements, distributed ledger has the potential to address de-risking. Robo-advisers could potentially be adapted to increase financial literacy and support customers in less accessible locations. The adoption of open Application Interfaces (API) facilitates a sharing environment whereby improvements build on existing innovations could shorten the time to market for more offerings.

These are just a hint of many more examples that can be examined. What is needed is a rethinking of today's most promising financial innovations for applications and new gains in financial inclusion. Or to put it another way, we need to look at not just innovative financial inclusion, but inclusive financial innovation!

Identifying and working on our blind spots: driving efficiency gains to promote sustainable financial inclusion

The reduction of poverty and greater social empowerment through financial inclusion has been one of most enduring achievements of our era. Building on this momentum, our ambitions to pursue deeper financial inclusion over the next decade must be rooted in a deep understanding of the unique circumstances faced by the 2 billion people who remain excluded from the formal financial sector. This involves increasing the arsenal of financial inclusion tools that can overcome both the geographical and cultural barriers to deliver meaningful financial services to this segment.

Ultimately, the provision of financial services to the underserved and unbanked must be economically viable for providers. In this aspect, the smart usage of technology can be a game changer in lowering the cost of financial intermediation.

This in turn will unlock opportunities to progress from the single, narrowly-focused products which are typically offered by traditional financial institutions today, to a broader range of relevant products and services tailored for the underserved segments. The ability to clearly demonstrate and consistently track efficiency gains over time can attract more providers into this space, while driving continuous efficiency improvements in delivering financial services to the underserved.

Great strides have been made in developing better measures of financial inclusion. We have moved beyond measuring access, to including measures of the usage and quality of financial inclusion services. We need to go further to include measurement on how efficiently we are increasing financial inclusion. Such measures do not exist widely, if at all, and have yet to be systematically propagated. This blind spot ignores one of the most important aspects of innovative strategies for financial inclusion, which is the potential to drive down the costs of delivering financial inclusion initiatives. A framework for evaluating financial inclusion efficiency can provide powerful incentives to harness technology in the most optimal way. This should drive lower the costs of delivering inclusive financial services over time, and thereby enhance the viability for both Governments and private actors.

Sustainability also calls for the strengthening of financial institutions that provide services to low-income and vulnerable groups. The misconduct or underperformance of such institutions can have a disproportionate impact on the poor simply because they have lower buffers. It can also significantly set back financial inclusion efforts by further entrenching the mistrust of formal financial institutions. It is therefore, critical for such institutions to exemplify strong and socially responsible corporate governance, and to have the appropriate technical expertise that will enable them to expand product offerings, increase outreach and develop alternative delivery channels. They must also be adept at identifying and managing financial and operational risks inherent in their business models. This requires investments in systems and in the development of talent with deep knowledge within the institutions.

Only then, can financial institutions expect to support the low income and vulnerable segments of our communities as long-term partners to create opportunities that will improve lives.

A clear picture of policymakers’ role in promoting an enabling environment for financial innovation and technology

Finally, policymakers can play a meaningful role to promote an enabling environment for innovation to support financial inclusion initiatives. I shall focus on three areas.

First, regulation should aim to be technology-neutral and outcome-focused, proportionate to risks and harmonized across sectors. A technology-neutral approach allows policymakers to assess the merits of innovations based on the outcomes, without fear or favour for the underlying technology. Regulation should be proportionate to the risks that products or institutions present to the broader financial system. This requires continued efforts to strengthen the capacity among national regulators and supervisors to assess the benefits and cost of regulation. Only then can we really move from proportionality as a concept to practice. Regulation between different sectors should also be harmonised to focus on activities that should be regulated, rather than the institutions conducting such activities. For example, if an e-commerce platform collects, pays interest on and mobilises deposits, a banking license may be necessary as public interest is involved.

Second, communicating clear expectations to the market while incorporating feedbacks through engagements with the private sector is important. Countries such as Australia, Hong Kong, the UAE, the UK, Singapore, and Malaysia have issued discussion papers, introducing a sandbox approach which allows fintech solutions to be tested in a controlled environment, with appropriate risk mitigation in place.

Dedicated resources have been allocated to collaborate with private sector innovators and assess the feasibility of technology. Jointly, these efforts serve to build public-private consensus on how to deploy financial technology, by:

a. Conveying national-level support for fintech innovations that place the customer firmly at the centre;

b. Providing clarity to the public on the applicability of regulations to fintech solutions; and

c. Supporting regulators and supervisors in understanding how underlying technologies function, as well as the benefits and risks.

Third, it is important to address the role of Governments in national financial inclusion strategies. This is particularly relevant in encouraging e-payments as a key lever to expand the outreach of formal financial services. A clear commitment by Governments can secure the political capital needed to create the infrastructure and policies to accelerate financial inclusion such as unique identifiers and mandatory electronic G2P payments. Policymakers should also seek opportunities to promote the interoperability of supporting infrastructure for new financial innovations. This will preserve healthy competition and strong incentives for providers to continue innovating value-add solutions that meet the real needs of consumers.

More often than not, small changes lead to major breakthroughs, if approached with an open mind and shared interests between providers and policymakers to genuinely serve the best interests of the unserved segments of society. In Malaysia, the agent banking initiative was an experiment in policymaking and regulation that has proved to be highly successful in both protecting the integrity of financial transactions, while significantly increasing financial inclusion. The agent banking initiative leveraged on existing high-volume touch points such as sundry shops, petrol stations and post offices to reach the rural population and perform basic banking transactions on behalf of financial institutions.

The technology involved was hardly state-of-the-art, relying on POS terminals with real time connectivity, to back-end system of banks as well biometric identification, to meet the Know-Your-Customer requirements. Yet, it has enabled 99% of Malaysians, particularly those in rural areas, to conveniently access financial services, while saving up to 80% of costs in building brick-and-mortar bank branches.

In February 2016, Bank Negara Malaysia also facilitated the implementation of the Investment Account Platform (IAP) which expands opportunities for retail and institutional investors to finance viable SME ventures more efficiently in a Syariah-compliant manner. Again, this was only possible because of technology.

Conclusion

This symposium is the inaugural gathering of public sector regulators, private sector innovators and funders that is specifically focused on how financial innovation can support financial inclusion. In its own way, this symposium sets out to disrupt the ordinary in order to achieve the extraordinary; invoke curiosity to inspire creativity; and challenge the conventional to embrace novelty.

With open minds and thoughtful exchanges, the next two days present an excellent opportunity to generate a critical mass of ideas that form the foundation for new strategic partnerships to be built, and existing ones strengthened. The time is now to deliver on the financial inclusion promise to the 2 billion unbanked and vulnerable people who continue to live in the most challenging financial circumstances. With an “eye for innovation”, I am certain we can spot the opportunities that will deliver that promise.