INTER-AGENCY TASK FORCE ON FINANCING FOR DEVELOPMENT

Issue Brief Series

Digital Financial Inclusion

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SUSTAINABLE DEVELOPMENT **G★ALS**
17 GOALS TO TRANSFORM OUR WORLD

FINANCING FOR DEVELOPMENT

Digital Financial Inclusion
International Telecommunication Union (ITU)

Despite the benefits brought by digital financial services and the efforts made to increasingly digitize cash transactions, there are still significant challenges to quickly and effectively leveraging ICT to meaningfully enhance financial inclusion. The full potential of mobile money has not yet been achieved, with 2 billion people in developing countries still lacking a viable alternative to the cash economy and informal financial services. 1.7 billion of them have mobile phones, but the industry has found it challenging to launch and scale services for the unbanked because many policy and regulatory environments are not genuinely enabling yet.

In this respect, the International Telecommunication Union (ITU) has set up the Focus Group on Digital Financial Services (FG DFS) in June 2014. The Focus Group Digital Financial Services, incorporating 60 organizations from some 30 countries, aims to bridge the gap between telecommunications and financial services regulators, and the private and public sectors. Representatives from across the DFS ecosystem are addressing some of the major issues currently preventing DFS from serving the unbanked ranging from interoperability, consumer protection, competition issues, regulation for DFS, security of transaction, quality of service, big data and digital identity. It is the unique forum which brings together regulators and players from both the telecommunication and financial services sectors.

The objectives of the Focus Group are twofold:

a) To create a framework for a more structured and regular dialogue and collaboration between telecom and financial services regulators who need to develop consistent policy and regulatory approaches to DFS and
b) To discuss some of the main policy and regulatory issues currently preventing the DFS from developing organically and reaching the poor

FG DFS is developing a set of operational recommendations, tools and solutions that will fast track policy reform to support numerous developing countries in implementing the financial inclusion strategy and promoting DFS at scale. The Focus Group is expected to complete its work at the end of 2016.

On 16 June 2016, the Focus Group has published the first of a series of thematic reports on Digital Financial Services:

- **The Digital Financial Services Ecosystem**: Maps the overall ecosystem of DFS, identifying all key stakeholders, and looks at the critical elements necessary to make the ecosystem develop so that it encourages and enables financial inclusion policies.
- **Enabling Merchant Payments Acceptance in the Digital Financial Ecosystems**: Describes the merchant services value chain, develops a segmentation scheme for different types of payments acceptors, and identifies the payments-related attributes of

each segment. It also develops suggestions on ways to accelerate the adoption of electronic payments acceptance.
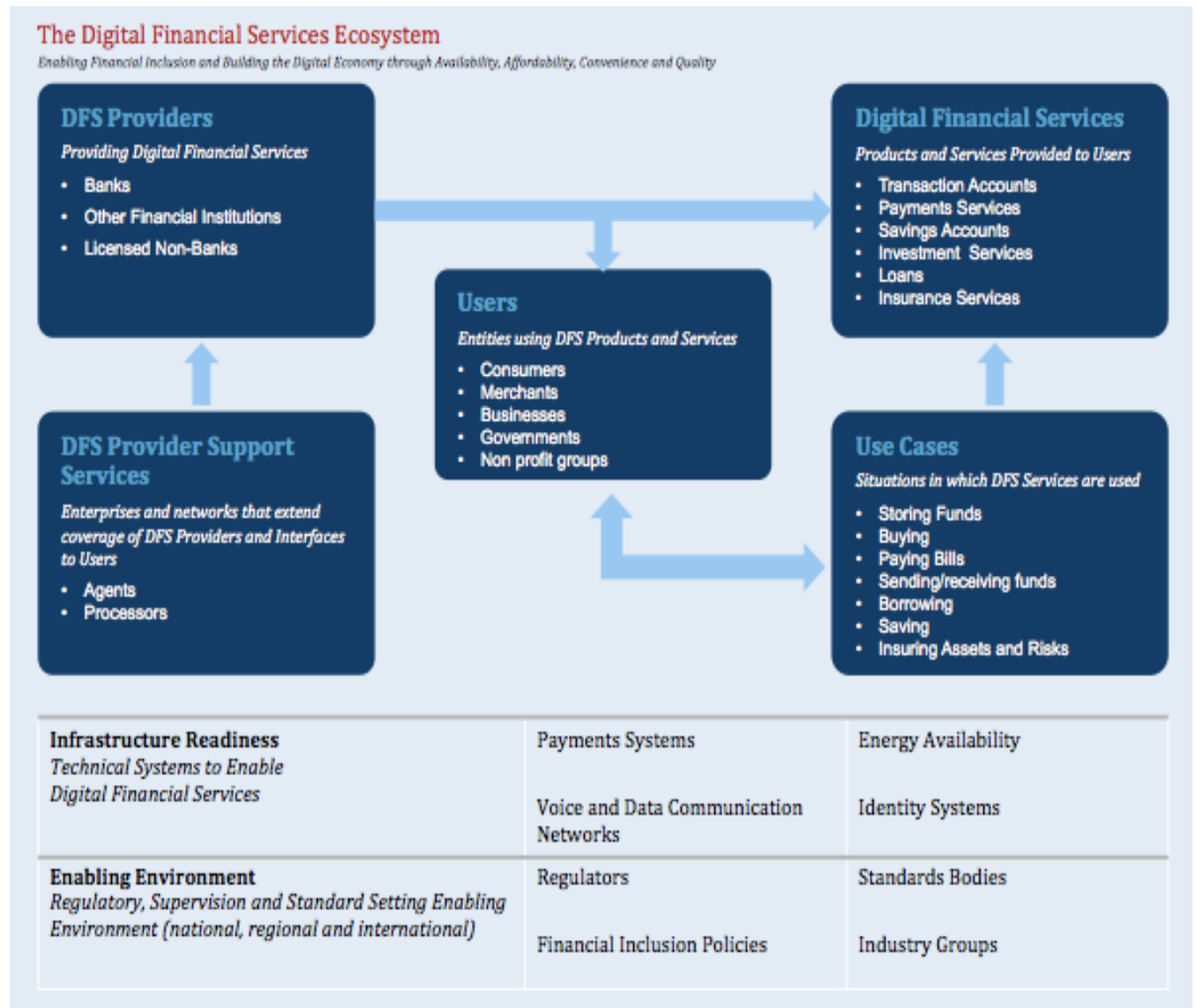
- **Review of National Identity Programmes – A report from the Evans School of Public Policy and Governance**: Looks at 48 national identify programmes in 43 developing countries. With identification systems becoming more common across Latin America, South and Southeast Asia, and Sub-Saharan Africa, the report concludes that not only is penetration much higher than expected, but so are the number of biometric national ID programmes. It evaluates how these programmes are being used to drive provision of DFS services.
- **Quality of Service (QoS) and Quality of Experience (QoE) aspects of Digital Financial Services**: This Report identifies and proposes Key Performance Indicators (KPIs) to be considered for digital financial services.

The remaining Focus Group deliverables will be published incrementally from now through to the end of the year, focused around the two remaining meetings scheduled in Tanzania, 19-22 September, and the final meeting in Geneva on 6-8 December 2016. The final recommendations are scheduled to be published in January 2017.

The DFS Ecosystem Report defines the digital financial services ecosystem and describes the players and their roles within the Ecosystem. These players include **users** (consumers, businesses, government agencies and non-profit groups) who have needs for digital and interoperable financial products and services; **providers** (banks, other licensed financial institutions, and non-banks) who supply those products and services through digital means; the financial, technical, and other **infrastructures** that make them possible; and the governmental **policies, laws and regulations** which enable them to be delivered in an accessible, affordable, and safe manner.

The goal of financial services made available via digital means is to contribute to the reduction in poverty and deliver on the recognized benefits of financial inclusion in developing countries. Financial inclusion means the sustainable provision of affordable financial services that bring the poor into the formal economy. An inclusive system includes a range of financial services that provide opportunities for accessing and moving funds, growing capital, and reducing risk. Such services may be provided by banks and other traditional financial services organizations, or by non-bank providers.

*Figure 1: Digital Financial Services Ecosystem*

The Digital Financial Services Ecosystem
Enabling Financial Inclusion and Building the Digital Economy through Availability, Affordability, Convenience and Quality

DFS Providers
Providing Digital Financial Services

- Banks
- Other Financial Institutions
- Licensed Non-Banks

Users
Entities using DFS Products and Services

- Consumers
- Merchants
- Businesses
- Governments
- Non profit groups

Digital Financial Services
Products and Services Provided to Users

- Transaction Accounts
- Payments Services
- Savings Accounts
- Investment Services
- Loans
- Insurance Services

DFS Provider Support Services
Enterprises and networks that extend coverage of DFS Providers and Interfaces to Users

- Agents
- Processors

Use Cases
Situations in which DFS Services are used

- Storing Funds
- Buying
- Paying Bills
- Sending/receiving funds
- Borrowing
- Saving
- Insuring Assets and Risks

Infrastructure Readiness *Technical Systems to Enable Digital Financial Services*	Payments Systems	Energy Availability
	Voice and Data Communication Networks	Identity Systems
Enabling Environment *Regulatory, Supervision and Standard Setting Enabling Environment (national, regional and international)*	Regulators	Standards Bodies
	Financial Inclusion Policies	Industry Groups

Source: ITU

The report recognizes a goal of reaching "digital liquidity" – a state wherein consumers and businesses are content to leave their funds in digital form, therefore reducing the burden of the "cash-in", "cash-out" process.

Figure 2: Digital Liquidity

Reaching Digital Liquidity
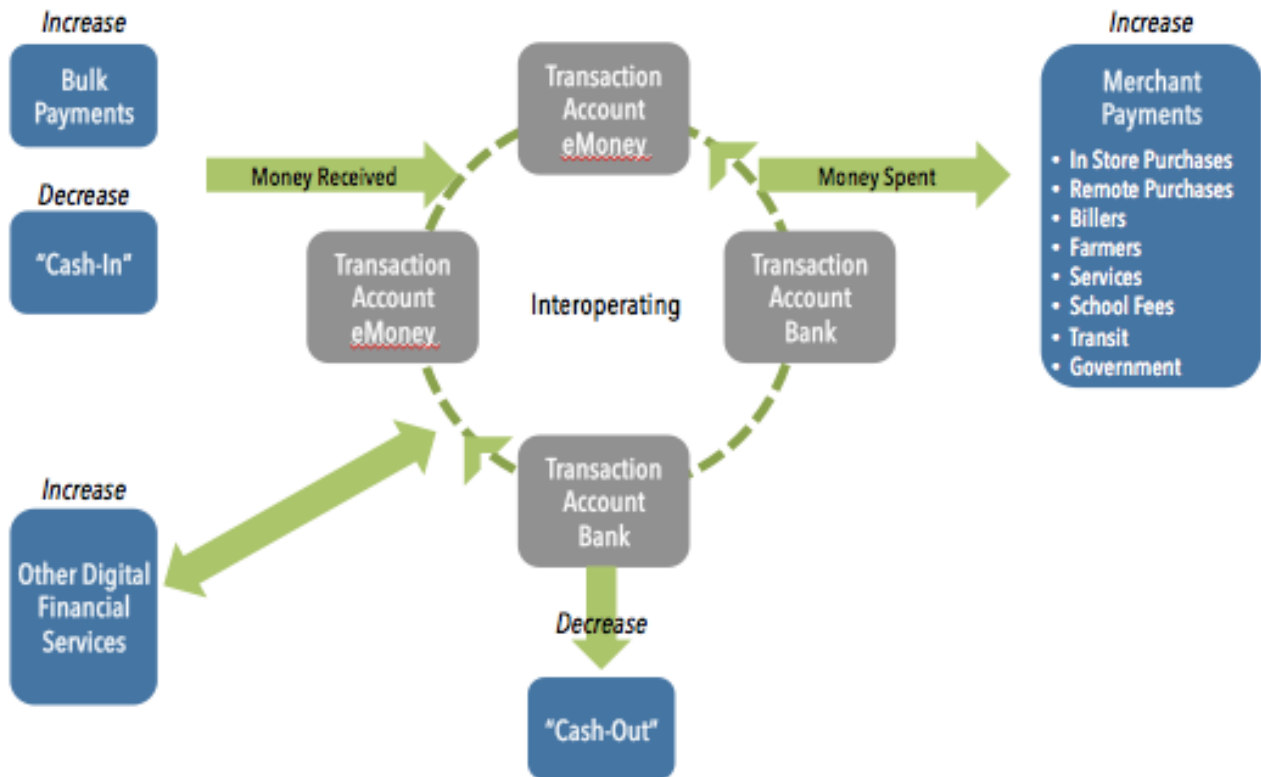
Source: ITU

The Enabling merchant acceptance in the DFS Ecosystem Report provides an analysis of some of the challenges small merchants face to accept digital payments and provides insight into some of the solutions for merchant payments. Merchant acceptance of digital payments is increasingly seen as a key element of the overall development of the DFS ecosystem. Broad merchant acceptance will help achieve digital liquidity by enabling poor consumers to spend a meaningful amount of the money they receive or deposit into digital wallets, eliminating or reducing the need to incur cash-out costs.

Countries throughout the developing world, however, are finding that there are considerable challenges in attaining merchant acceptance of digital payments. The report defines and describes the merchant payments value chain and provides a definitive categorization of merchant segments, and recognizes that the needs of each merchant segment are quite distinct. The report contains a segmentation of the small merchants by category and the needs of each and the types of incentives which would be appropriate for each category type. Various economic models for the provision of merchant acceptance are defined and discussed, and policy considerations for regulators are noted. The report also looks at various business models and structures used by providers of merchant services, and includes an extensive list of those services that are currently in the market.

The National Identity Review report analysed the status and characteristics of 48 national identity programs and initiatives in 43 developing countries, including an evaluation of how these programs are being connected to—or used for—digital financial service provision . The identity programs reviewed are mainly government-issued national IDs. However, other types of national identity programs with links to various services including voter cards, passports, and two programs targeting the poor and the banking population were also reviewed. Some of the key findings of this report are:

- Government-issued national IDs are the most common form of national identity program reviewed (38 of 48 programs).
- 28 programs have an electronic component and 37 programs employ biometric information, most commonly in the form of fingerprints. 16 programs incorporate multiple biometrics into their IDs, usually combining fingerprints with face or iris scans.
- 35 of the 48 national identity programs are operational and in use, meaning they have completed initial enrollment and begun using the IDs, though ten of these are still actively enrolling new participants. Three programs are planned initiatives which have not yet begun enrollment, and three are actively enrolling but not yet operational.
- 39 programs report implementation challenges in some form. We identify seven general categories of challenges: accountability, privacy, data management, enrollment, coverage, cost, and harmonization of ID programs.
- Coverage of particular geographic or demographic groups is the most commonly reported challenge (22 programs). 20 programs report challenges in two or more of the categories we identify.
- IDs are most commonly used for Know Your Customer (KYC) purposes, especially for financial transactions and elections. 22 ID programs are mentioned as accepted credentials for banks to verify customer identity, and 21 are accepted forms of identification to vote.
- Five ID programs are linked to digital banking and four have mobile money applications. 13 programs are linked to government transfers, such as relief or welfare.

This Quality of Service (QoS) and Quality of Experience (QoE) aspects of DFS Report summarizes the main issues affecting the QoS/QoE for DFS transactions and provide suggestions for stakeholders involved in DFS taking into account regulatory and consumer related aspects. It analyses different use cases and the applicability of currently available standards. The report suggests some technical key performance indicators for QoS which would need to be studied and defined.

Since the number of technical KPI is overwhelming and target values cannot be set on a global level, the report provides a novel scheme, which enables stakeholders in any region or country to assess the fitness of networks, terminals, users, DFS implementations and society / government of the use of DFS implementations. The outcomes of this report will be discussed in ITU-T Study Group 12 on Performance, QoS and QoE to standardize some of the KPIs proposed.