CAREC

CAREC Economic and Financial Stability Cluster 2021

High-Level Policy Dialogue on Covid-19 Pandemic and Financial Inclusion

1 July 2021 • Virtual meeting

SUMMARY

Senior officials from central banks, financial regulatory authorities, and finance ministries from CAREC countries, together with representatives from the ADB, International Monetary Fund, the World Bank, CAREC Institute, and fintech companies discussed financial inclusion challenges and opportunities in the backdrop of the circumstances brought by the COVID-19 pandemic.

Opening, Welcome, and Keynote Speeches

Moderator: Mr. Safdar Parvez, ADB

Azerbaijan: Mr. Rashad Orujov, Executive Director, Central Bank of the Republic of Azerbaijan, opened the forum. He provided a background on the effects of the COVID-19 pandemic globally and in the CAREC countries. The Azerbaijan government implemented multilayered policy responses to the pandemic and set its digital finance aspirations in its national strategy for 2016 to 2020. They have implemented two programs: (1) enhancement of national payment system infrastructure to expand cashless payments; and (2) the "Instant Payment System" and the "Bank Identity Platform," which allows remote identification of customers. They will soon draft and enact the law on payment systems and organizations to regulate digital and fintech activities. Azerbaijan will build on sound technological infrastructure to digitize traditional financial and banking services and products such as deposits, credit, and capital raising. CAREC is an important knowledge and experience-sharing platform to address the challenges of financial inclusion and fintech.

ADB: Mr. Eugenue Zhukov, Director General of Central and West Asia Department, delivered the welcome remarks. He emphasized that even before the COVID-19 crisis hit, financial inclusion was already a priority in the strategic reform agenda of many CAREC countries and the development support programs of multilateral development banks such as ADB, IMF, and the World Bank. However, many CAREC member states lag in providing services and infrastructure critical to increasing financial inclusion. The COVID-19 crisis has highlighted the urgency for government and fintech companies to work closely together to create a conducive regulatory environment that facilitates the development of innovative financial solutions.

World Bank: Ms. Lalita Moorty, Regional Director, Europe, and Central Asia, World, provided the keynote speech. According to World Bank data, financial inclusion is improving in CAREC countries. Before the pandemic, account ownership in Central Asia and the South Caucasus doubled from 20% to 40% in 2017. However, this number is still meager (compared to Western European countries), the poor represent a disproportionate share of the unbanked, and in some countries, gender and rural population gaps remain high. She made three points.

First, ensuring financial stability during Covid-19 recovery is key to maintaining financial inclusion. The negative economic effects of covid-19 still persist. The discontinuity of relief schemes as the global economy recovers will put pressure on asset quality. We may face a significant increase in non-performing loans (NPLs) and heightened risk aversion by lenders. To address this, (1) strengthen regulation and supervision to identify problem loans; (2) prepare banks to work out rising volumes of problem debt (including methodologies to compare expected recovery scenarios and assess the viability of distressed borrowers); and (3) solve issues with insolvency frameworks and creditor rights (legal certainty will help banks realize their claims in a predictable manner and allow viable borrowers to recover).

Second, the role of appropriate policies to support innovation and new technologies in the digital finance services is critical. Innovation comes with risks, and policymakers must strive for a very delicate balance. To address the risk of digital monopolies, we must ensure a level playing field and common standards, and rethink competition policies to capture new dimensions such as financial data (not just prices). Further, a loss of confidence in digital technologies (e.g., cybercrimes involving money laundering and data privacy) can negatively impact financial inclusion. Thus, regulators will have to weigh consumer protection, Anti-Money Laundering (AML)/ Combating the Financing of Terrorism (CFT) considerations, and financial resilience against the benefits of financial innovation.

Third, the fundamental reforms in financial sector should be continued to further advance financial inclusion. Address the lack of trust in financial institutions by fostering macro-financial stability, enhancing disclosure requirements for banks, strengthening deposit insurance systems, and increasing financial literacy. Also, examine the public interventions that restrict competition in financial services. Spurring competition can enhance efficiency, offer better and cheaper products to finance consumers, and expand services to new market segments. In addition, enact legal reforms to ease the use of collateral and protect debtor-creditor rights, leading to credit with longer maturities and lower rates. Lastly, improve credit information-sharing systems and accounting and auditing standards.

Session 1: Challenges to Financial Inclusion and Policy Responses – Pre-, Peri- and post COVID-19 Pandemic
Moderator: Mr. Tariq Niazi, ADB

What are the challenges to financial inclusion, pre-, peri- and post-pandemic, and what have been the policy responses taken so far by each country?

Pakistan: Ms. Sima Kamal, Deputy Governor, State Bank of Pakistan (SBP), stated that financial inclusion is a key policy priority for Pakistan. SBP launched a National Financial Inclusion Strategy in 2015 which served as an enabling framework for financial inclusion. It helped increased account ownership from 2 out of 5 adults in 2017 to 3 out of 5 adults in 2020 and women's access to accounts from 1 out of 5 women in 2017 to around[1] 2 out of 5 women in 2020. However, challenges remain in the limited usage of these accounts and the gender gap. In response to the COVID-19 pandemic, SBP has undertaken measures amounting to approximately 5% of Pakistan's GDP including waived charges on digital fund transfers, which increased digital transactions and registered mobile banking users from 7.3 million in 2019 to 9.3 million in 2020.

For the post-pandemic period, financial innovation should continue. In this regard, SBP recently launched a new system, "Raast" - a micropayment gateway and will launch a policy measure to close the gender gap in banking equality. It is also exploring ways to address the issue of preference for/reliance on cash and to

[1] Actual ratio is 34%, which translates to 1.5.

promote microfinance. The global Pandemic situation remains uncertain hence focus on balancing health and economic growth will remain a challenge requiring careful calibration. Focus will remain on increasing financial inclusion via Digital Innovation and ensuring financial stability as the country exits Covid forbearance measures.

Uzbekistan: Mr. Abrorkhuja Turdaliyev, Deputy Chairman, Central Bank of Uzbekistan, stated that financial inclusion is considered as one of the main drivers of economic growth. Uzbekistan improved its legal and regulatory framework for financial inclusion by adopting new laws and policy measures, including the Law on Central Bank (2019) to protect consumers' rights, increase the availability of financial services, and improve the level of financial literacy; the President Decree on Measures to Increase the Availability of Microfinance Services (2019); the Law on Payments and Payment Systems (2019) for the effective regulation of the payment services market[2]. In addition, the National Strategy for Improving Financial Inclusion for 2021-2023 has been drafted (with the support of the World Bank), covering five areas[3] to improve financial services. Moreover, the central bank adopted digital technologies to advance financial inclusion. For example, it launched a website to raise public awareness of economics and finance. Uzbekistan is also developing the infrastructure for retail payment systems to provide bank card-related services[4], modernizing payment services using Near-Field Communication (NFC) technology, new softwares, and Quick Response (QR) system, and operating electronic money systems (Oson, CLICK, E-CARD, Wooppay, and Alifmobi).

The pandemic demonstrated the need to accelerate the development of innovative technologies in the banking and payment system, expand non-bank financing instruments, and increase the financial literacy of the population, which will constitute the main directions of the central bank's activities to increase the level of financial inclusion.

What sort of support CAREC countries expect from international financial institutions (IFIs) in terms of policy and financial support to deal with financial inclusion challenges?

Afghanistan: Ms. Salma Alokozai, Director General, Macro Fiscal Forecasting, Ministry of Finance, shared that CAREC member countries, including Afghanistan, face a substantial gender gap in account ownership and limited access for small and medium-sized enterprises (SMEs) to financial services. The COVID-19 pandemic has exacerbated the situation. In response, the government of Afghanistan launched the National Financial Inclusion Strategy (2020-2024). Also, with support from development partners, the government provided loans for SMEs and helped banks improve their capacity to manage their loan portfolios, strengthened rural women's agricultural capacities to enhance agriculture value chains, and improved the national credit guarantee mechanisms. Despite these efforts, challenges in advancing financial inclusion remain, such as financial security issues, slow economic recovery from the pandemic, social and cultural

[2] There are five payment systems in the payment services market, of which three are payment systems of the Central Bank (Interbank Payment System, Cashless Settlement System, and Instant Payments System) and the other two (UZCARD and HUMO payment systems) are legal entities licensed by the Central Bank in accordance with the applicable procedures.

[3] 1. Expanding coverage of basic financial services; 2. Development of digital financial services; 3. Improving the financing of small businesses; 4. Strengthening the protection of the rights of consumers of financial services; and 5. Increasing financial literacy of the population and entrepreneurs.

[4] As of June 1, 2021, the total quantity of bank cards in the country is 23.8 million; the total quantity of installed terminals is 439,000; the total quantity of installed ATMs and self-service terminals is 12,200 .

barriers preventing women from accessing bank accounts, and documentation requirements for SMEs' loan requests. Afghanistan expects policy and financial support from IFIs to address these challenges.

CAREC Institute: Mr. Syed Shakeel Shah, Director, presented the key findings of two CI papers: 1) Promoting Fintech to Meet Underserved Needs in Trade Finance in CAREC (2021)[5] and 2) Financial Inclusion and Fintech in CAREC: Constraints and Prospects (2021). Among the data he highlighted are that the population's wealthier segment is more likely to have an account as compared with lower-income groups and that the percentage of the population with access to a financial institution is very low (ranging from 1 to 2% in Azerbaijan, Afghanistan, Pakistan, and Turkmenistan in 2017). Two main factors that impede financial inclusion in the CAREC region are the absence of an integrated national strategy (only available in Pakistan (2015) and Tajikistan (2012)) and limited institutional capacity. For instance, according to the IMF, the share of the shadow economy is still large, and the CAREC countries display low financial development in terms of depth, access, and efficiency of financial institutions and financial markets.[6] CAREC member state governments are encouraged to i) invest in quality digital infrastructure, ii) enable regulatory environments, iii) build people's trust in financial services, and iv) facilitate the transition from informal channels to the formal channels of financial services. Multilateral development partners should mainstream financial inclusion in country-specific support programs and develop country partnership strategies focusing on financial inclusion with measurable targets.

IMF: Mr. Jihad Azour, Director, Middle East and Central Asia Department, stressed the need to focus on macro-financial stability. The alarming increase of bank and sovereign debt may impact monetary policy trends globally, leading to increased interest rates. As a result, the risk of capital outflow and the excessive reliance on domestic banks to finance sovereign debt would grow, which could negatively affect the capacity of banks to provide financing to the private sector. He also mentioned the need to create new opportunities in new sectors such as fintech and green recovery and to further develop the global value chains. Central banks with the capacity to continue providing support measures to the private sector should maintain it.

Finally, countries can learn from each other about what has worked and what has not. IMF's research has shown that promoting financial inclusion for SMEs through public interventions could address some market failures. For example, public credit guarantees may help reduce collateral requirements and credit risk, if designed carefully. While the IMF generally recommends against tax exemptions due to their adverse impact on revenue and possible market distortions, there can be exceptions to induce positive externalities, including for SMEs. However, development banks'/funds' tampering with supervisory and macroprudential measures and interest rate caps are not recommended.

World Bank: Mr. Ilias Skamnelos, Practice Manager, Europe, and Central Asia, proposed for IFIs and development partners to continue to be trusted advisors and provide timely support for three main challenges that developing member countries typically face. The first challenge is about difficulties in policy targeting. As governments face limited fiscal resources, IFIs and development partners must support governments to provide appropriate financing and policy support to the targeted group of firms that are

[5] The key findings were presented at the CAREC Institute Research Conference on post-COVID-19 recovery (…). The final materials will be published at the end of 2021.

[6] The IMF measures the relative depth, access, and efficiency of financial institutions and financial markets. Using a scale of 0 to 1, where one denotes strong, and 0 denotes weak financial development : Afghanistan (no data), Azerbaijan (0.20), Georgia (0.30), Kazakhstan (0.34), Kyrgyzstan (0.12), Mongolia (0.40), Pakistan (0.24), Tajikistan (0.09), Turkmenistan (0.11) and Uzbekistan (0.22).

viable but face financial distress and insolvency because of the pandemic. The second challenge is about determining the timing to phase out the fiscal stimulus and monetary easing policies. Exiting too early will bring procyclical effects. Too late will distort resource allocation. How do we avoid a credit crunch, manage potential non-performing loans, and realize a productivity-driven recovery? Policymakers and the national financial institutions should swiftly attend to non-performing loans and immediately implement reforms on insolvency and restructuring to avoid legal uncertainties. The third challenge is how to manage the tensions around technology. According to a recent World Bank survey, only about one-third of businesses have increased the use of digital technology in response to the banking crisis. We need to devise policy and support mechanisms to incentivize firms to innovate and adopt technologies while helping governments deal with monopoly issues of large fintech companies.

Session 2: Panel Discussion – Drivers of Financial Inclusion: Fintech and Innovative Financial Solutions
Moderator: Mr. Junkyu Lee, ADB

What are the innovative solutions to promote financial inclusion? What have been the challenges (e.g. regulatory constraints, lack of IT infrastructure, lack of policy coordination, etc) and responses?

Georgia: Mr. Koba Gvenetadze, Governor of the National Bank of Georgia, stressed the country's dedicated support to financial technology and innovation while focusing on the traditional side of financial inclusion: financial education and consumer protection. Considering the complexity of the regulatory framework, Georgia has set up an Innovation Office that aims to help innovative ideas turn into marketable and legally acceptable business models. Georgia also established a regulatory sandbox that allows regulated entities to test new ideas and make a case for a regulation responsive to evolving market needs. Further, Georgia introduced an enabling digital banking regulatory framework that significantly lowered capital requirements at the early stage. With introduction of the digital banking license, they expect to develop fintech business models such as branchless banking, wholesale banking, and white-label services (outsourcing of financial services). An open banking framework is another example of innovation. Open banking allows third party service providers to be able to access consumer database and profiles and provide tailor-made services and products through various digital channels.

In Georgia, financial inclusion, if measured by the number of accounts and financial transactions, is substantially high. However, the number of people defaulting on loans (mainly consumer loans) and blacklisted by the credit bureau is significantly increasing, which meant losing clients in the formal financial sector. Thus, Georgia has introduced responsible lending principles for financial institutions to follow and conduct systemic credit risks assessments of the clients. As a result, the number of households and SMEs accessing to formal financial services has increased over the years. Georgia is also very active in developing online payment systems.

PRC: Ms. Yuan Lyu, Deputy Director, Innovation Department, Digital Currency Institute, People's Bank of China participated in the forum.

What could be the roles of regional cooperation platforms such as CAREC to effectively support member countries to promote financial inclusion through innovation?

Ripple: Mr. Bob Chakravorti, Chief Economist**,** shared how Ripple is trying to democratize financial systems just as the internet democratized information. Ripple helps billions of people access the global financial system and leverage blockchain and cryptocurrency to provide global payment services and increase its use-cases beyond payments such as commodities trading and enterprise transaction platform. Recently, the company has been working with payment service providers such as bKash, the largest mobile wallet provider in Bangladesh, on remittances for thirty-six million consumers using the app and of which 90% are newly banked, and with Floodway, a provider of B2B payment services for sixty thousand plus businesses (many of them SMEs) in Nigeria.

One challenging area is remittance payments, which account for a significant portion of payment inflows in many developing countries. Remittances are critical for economic growth. For example, in Kyrgyzstan and Tajikistan, remittances are equal or greater to a third of each country's GDP. RIPPLE offers solutions for the conventional cross-border remittance payments which lack transparency around fees and suffer from slow transaction due to lack of competition and technology. The COVID-19 pandemic has further highlighted the importance of effective digital end-to-end payments infrastructure. Although digital solutions are gaining traction, cash transactions in the region are much more common; sixty percent of remittances today are not sent digitally around the world. CAREC region should further explore and promote ways to improve financial services by accessing technologies from global fintech based financial service providers.

VISA Inc.: Mr. Salvador Perez-Galindo, Vice-President, CEMEA Government Engagement, discussed VISA's views on the opportunities and challenges of the fintech space in Central Asia. VISA is leading the way in connecting Central Asia's fintech space to the extensive global network of merchants and transaction accounts.

The opportunities to develop the fintech ecosystem in the CAREC region are enormous, and VISA contributes to this by providing an opportunity for fintech companies to connect with incumbent players. Maintaining the principle of collaboration is very important —this is not a zero-sum game. The more success they have in bringing new players and new solutions and collaborating with incumbent players, the more impactful and contribution they will have for fintech development. In Georgia, Payze (a startup innovator of financial transactions), won the "VISA Everywhere Initiative" fintech competition. The hope is for this company to expand operations in all of the Central Asia region—it already has plans to go to Azerbaijan, Kazakhstan, and Uzbekistan. VISA also sees great opportunities in addressing SMEs' needs in e-commerce and is committed to providing solutions to this market. They expect to serve at least five million SMEs in the next few years.

There are five key challenges to fintech's development in the CAREC region: (1) low telecom connectivity (a basic foundation); (2) regulatory fragmentation: the need for convergence in licensing requirements, in e-KYC, in digital onboarding; (3) pricing interventions need to be cautious given the two-sided nature of payment markets (i.e., balance demand from both buyers and sellers); (4) scalable and interoperable solutions; and (5) ensuring security and data protection.

Tajikistan: Mr. Mirhayot Yoqubzoda, Deputy Chairman, National Bank of Tajikistan, discussed the whole scale of important measures that the government has undertaken to ensure the country's economic stability, particularly maintaining the balance of payments and support to healthcare. Specific measures to support the financial markets during the pandemic include easing borrowing and lending conditions for banks, promoting loan restructuring and lowering of reserve requirements. These measures resulted in the sustainability of the country's banking system. The Government of Tajikistan is prepared to continue implementing measures to support the recovery of its economic and social sectors.

Summary and Closing Remarks

IMF: Mr. Jihad Azour, Director, Middle East, and Central Asia Department, summarized and closed the forum.

Mr. Azour noted that policymakers should devise a holistic approach to promote financial inclusion, covering three approaches: (i) macroeconomic and financial stability, (ii) strengthening institutions and policy frameworks, and (iii) improving the business environment. He also acknowledged the need for IFIs' expanded support for member countries in various forms, including through technical assistance programs, financing facilities, and facilitating information-sharing. Innovations in financial technologies could contribute to financial inclusion; on the other hand, constraints are arising from infrastructure deficits, regulatory frameworks, and coordination issues.