Financial Inclusion Task Force in the Arab Countries

Innovative Methods for Increasing Responsible Financial Inclusion

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The opinions expressed in this policy paper are those of the authors from the Financial Inclusion Task Force members and do not necessarily reflect those of the entities they represent.

Any queries regarding this policy paper should be addressed to:
Financial Sector Development Division, Economic Department
Arab Monetary Fund
P.O. Box 2818
Abu Dhabi, United Arab Emirates
Tel. +9712-6171552
E-mail: financialinclusion@amf.org.ae; economic@amfad.org.ae; fsd@amfad.org.ae.
Website: www.amf.org.ae

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Introduction[1]

Financial inclusion stands for the efforts made by authorities to make financial services accessible to all individuals and businesses. Financial inclusion allows deleting barriers that exclude people from the formal financial sector. In this context, the World Bank claims that "*financial inclusion facilitates day-to-day living and helps families and businesses plan for everything from long-term goals to unexpected emergencies. As accountholders, people are more likely to use other financial services, such as savings, credit, and insurance, start and expand businesses, invest in education or health, manage risk, and weather financial shocks, all of which can improve the overall quality of their lives*". The financial industry brings new ways to present services to the individuals and businesses and makes profit from this. In this context, Fintech, such as cashless digital transactions, low-fee robot-advisors, and crowd funding, has provided innovative instruments to address the financial inclusion issue. It is also worth noting that peer-to-peer (P2P) lending raises extensively in the developing economies, where individuals and businesses do not access to traditional bank financing.

The use of big data and digitalization is introduced through information intermediaries, or providers of most accurate, detailed, and extensive digital information on individuals which can be used to analyze and formulate credit prices (AFI, 2018). Big data allows companies to minimize costs and maximize earnings by establishing projections on what people will undertake and then making changes to address their needs.

Data can be gathered from multiple digital sources. As a result, big data, sophisticated algorithms, and artificial intelligence are used to formulate credit scores. Credit rates can adjust in correlation with risk and are continuously updated. This approach is more reliable to provide low-costed financial products and services to individuals and businesses (AFI, 2018). However, the development and main reliance on this technology for Financially Excluded Peoples (FEPs) relies on the foundation of data. Since there is a risk of FEPs lacking basic technology adaptation, the algorithms in place may not have the necessary amount of information to formulate accurate credit scores. In that regard, Fintech may play crucial role in optimizing data collection.

Further developments in this approach, which are currently being tested, are the combination of big data and behavioral economics. This involves the creation of credit scores for mobile phone users by analyzing behavioral pattern of calls and text messages. Through behavioral patterns, an algorithmic analysis can assess the appetite for financial services and payment default risks. Fintech companies use online games or questionnaires to generate behavioral data which are then analyzed through a predictive algorithm to

[1] The Secretariat of the Financial Inclusion Task Force in the Arab Countries thanks the Banque du Liban for preparing the paper.

establish a psychometric score.

Despite that, the concept of behavioral economics is criticized by its lack of accurate predicting power as analysis can be based upon biases. However, Pūce (2019) mentions that some biases observed in decision making are systematic which are likely to be predictable. Hence, the reasons behind behavioral economics in applied forms of "nudges" have been popularly used in policy formulation. Furthermore, asset market critics argue that behavioral theories are considered invalid because markets are efficient, as per the Efficient Market Hypothesis developed by Eugene Fama.

The hypothesis states that individual behavioral irrationalities are abolished by group or market responses (Fama, 1970). Even though behavioral biases and other inefficiencies can appear in analysis, it is thought that market forces will regulate behavior back to rational levels. Thus, implying that irrational behavior in asset markets is irrelevant (Lo, 2005). However, Pūce (2019) refutes that criticism by stating it is unequivocal as anomalies and tendencies for markets to correct behavior does not cancel out the systematic deviations from market efficiencies.

1. Digital Technologies

1.1. Banks during the COVID-19 Pandemic

The COVID-19 pandemic has changed the customers' behavior, thus accelerating digitization of banking services, which let individuals visit banks less frequently. In this context, according to a survey from A.T. Kearney, it is found that about 85% of customers who have opted for digital financial services to pursue their transactions digitally once the COVIV-19 pandemic subsides, thus allowing banks to save more money. However, banks face challenges with regards to the increased reliance on digitalization.

Fintech developments lead to reformulate the business models of the financial industry by offering reliable solutions for the spread of financial products and services and improving their quality and influence, in addition to innovative instruments and ways to increase digital financial inclusion. In this context, government authorities play a crucial role in providing the right conditions for the financial services providers and in facing the challenges and the risks related to the digital transformation to properly protect the consumers. It is worth noting that banks can improve their financial services and products addressed to customers and their business performance based on social media data. Furthermore, social media data allows banks to enhance their decision-based marketing.

Banks can establish deep knowledge of their customers' behavior and decision-making processes based on the contribution of social customer relationship management and generate pricing models for several banking services and products based on social media data, considering the individual customer preferences by even increasing the share of the customer’s wallet to attract new customers.

1.2.Leveraging Social Media in Banking

Banks can take advantage from social media data in many areas. Indeed, they can create suitable banking services and products related to important dates of the customers such as birthdays and wedding days based on social media. Banks can also inform customers about new products and services and operational changes through social media channels. Moreover, banks can obtain ideas on how customers think about the new banking services and products through the likes and comments posted on social media, thus helping them deal with their needs and, thus, establish more personalized banking services and products. Banks can also reach customers excluded from the formal banking sector through the information available on social media. Social media channels can help banks address the challenges and issues faced by the customers, which allow them to deal with these issues effectively to improve their services and the customer relationship process.

2. Role of Digital Culture in Promoting Responsible Financial Inclusion

2.1. Digital Culture and Digital Literacy

Digital culture programs are supposed to support people to deepen their awareness of these needs and challenges, and to provide them with the tools, knowledge, networks, and support needed to launch sustainable social initiatives that generate positive change.

Digital literacy programs must be closely related to educational institutions, including community centers and schools, to integrate technology into educational systems and to change the way teachers and students interact. This promotes a digital culture among teachers, creates appropriate tools and solutions, and enables technology to reach the classroom.

The goal of the program is to mobilize capabilities to take advantage of technology development by:

- Supporting youth with leadership skills to change the educational system through educational technology.
- Developing digital entrepreneurial skills among youth.
- Supporting college and university graduates to be innovative.

These programs allowed professors to develop skills in information and communication technology, media literacy, digital citizenship, etc., and helped them gain the confidence needed to create a technology-rich environment that ensures optimal learning for pupils.

2.2. Digital Transformation

To make the most of the digital transformation and the infrastructure it provides, an integrated ecosystem for the ICT sector should be built that focuses primarily on building the ecosystem for technical talent and is concerned with providing the necessary care for them. The good thing is that young people constitute most of the population, and this is a very important feature that provides the Arab world with great potential not only to achieve digital transformation, but also to train a new generation of information and communication technology leaders who will take charge of development and future development by making the most of modern technology and putting it in the service of their people.

3. Protection of Personal Information

Consumer protection is related to the current challenges imposed by the phenomenon of accelerated globalization, which often have negative effects on the Arab consumer, exposing his safety, health, and material interests to risks, which requires caution, and serious research into the mechanisms that guarantee his right to protection, preserve his rights, and possess the skills of detection Marketing fraud and deception that may be practiced on it. The issue of consumer protection in the banking and financial sector has witnessed global attention, especially after the 2008 global financial crash.

Since 2005, the World Bank has started to assess several countries on the extent to which they apply international best practices to protect banking customers and has developed action plans and implementation programs for many countries in addition to granting loans to these countries to develop the issue of customer protection, awareness, and education.

In October 2011, the OECD issued a set of Principles on Financial Consumer Protection in cooperation with the Financial Stability Board and at the request of the G-20 and central bank governors. In 2012, the World Bank issued a report on good practices for consumer protection in the banking sector. It also issued two reports in 2013 and 2014 under the title "**Global Survey on Consumer Protection and Financial Literacy**".

The best principles and practices for customer protection in the banking sector are divided into several axes, which are the following:

- The legal framework

- The supervisory authority
- Fair dealing
- Disclosure
- Financial education
- Responsible credit
- Handling complaints

Activating and strengthening customer protection in the banking sector contributes to the following:

- Establishing long-term stability in the banking and financial system.
- Building trust between banking institutions and customers.
- Addressing the imbalance between the service provider or financial product and the customers.
- Enhancing transparency and disclosure, which helps in developing financial markets.
- Encouraging the entry of additional dealers in the financial markets, which contributes to the activation of Financial Inclusion.

The desired objectives of issuing laws or circulars related to consumer protection in the banking sector are the following:

- Enhancing transparency in dealing between banks / financial institutions and customers.
- Promoting the principle of fair dealing with clients and pay attention to their legitimate needs.
- Creating a new culture of professional behavior around dealing with the client.
- Enabling clients to submit reviews and suggestions.
- Activating the processing of customer reviews in a professional and prompt manner.
- Enabling clients to know their rights and duties and make comparisons between the offers submitted.
- Identifying the problems that the customer is exposed to by monitoring and controlling the market.

Summary and Recommendations

In the end, will banks, financial institutions and fintech companies really be able to bring most of the marginalized people into the formal financial sector, even though they are based in their applications on computers and smartphones to complete their work? Will it allow its marginalized and low-income users to complete financial operations via "rudimentary" phones that do not need the Internet since the network infrastructure does not exist in the areas where most of them live?

Another obstacle to the completion of a financial inclusion plan is non-compliant with the global legal regulations of identity requirements and "Know Your Customer" laws because most of the poor lack identification papers, a permanent housing address, electricity, water, and other bills to prove their identity and source of income.

Legislators and regulators should pass laws and circulars that allow the adoption of new digital finance and digital payment systems by working on the following:

- The issuance of a unified digital identity.
- Issuing circulars and laws allowing electronic signature, electronic money, and electronic checks.
- Reduce the procedures and documents imposed in accordance with compliance requirements and know your customer (Risk Based KYC or Tiered KYC) to facilitate their access
- Facilitate innovation in financial technology by establishing an experimental environment (Sandbox).
- Enhance the digitization of all processes and applications.
- Creating and organizing the work of the mobile wallet and its functions, payments, and transfers by electronic and mobile payments.
- Promoting financial and digital culture by working with educational institutions, including community centers and schools, as well as municipalities and NGOs.
- Protect personal data by taking the customer's prior consent before using their data in accordance with the new Personal Information Protection (GDPR) laws issued by the European Union.

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