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Role of Digital Financial Services in Promoting Inclusive Growth in Bangladesh: Challenges and Opportunities

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Abstract

Increasing access to financial services through digital financial services (DFS) and mobile technologies is crucial for Bangladesh. Rapid growth in mobile money customers coupled with demographic, economic, social and technological changes offer wide opportunities of financial inclusion for all people including women and other excluded groups. Being both pro-growth and pro-poor, DFS will contribute to financial growth and stability on the one hand and promote rapid and inclusive growth to reduce poverty and inequality and promote shared prosperity and social cohesion, on the other. For rapid digital financial inclusion, the government is laying the groundwork through regulatory and other supportive measures, while an innovating private sector is driving the shift from cash to digital. In fact, DFS present a unique opportunity for Bangladesh to close the financial inclusion gap that has persisted for decades and improve service delivery, enhance transparency and accountability, increase operational efficiencies, reduce costs of operation, and overcome many development challenges. Bangladesh needs to move faster to take full advantages of digital finance since the ecosystems take time to develop; and many barriers need to be removed to ensure the progression from payments to solutions 'beyond payments'. An enabling policy and regulatory environment for DFS is important which includes mobile financial services, branchless banking, electronic money, digital payment solutions and other new technologies available to promote DFS as a major driver of greater financial inclusion. The guidelines for DFS should enable and foster innovation; develop tools and techniques for increasing competition; and managing risks. The need is to deliver services that are safe, offer good value for money, and are likely to generate benefits for the poor clients. For the purpose, financial regulators need to: (i) set and enforce rules to ensure that retail services are offered transparently, providers treat customers fairly and do not put them at risk, and effective mechanisms exist to address customer complaints; (ii) improve product design and services including standards and codes of conduct; and (iii) raise consumers' awareness and strengthen their financial capability helping them to behave responsibly and protect themselves. For moving forward, the introduction of a 'Regulatory Sandbox' can be a useful mechanism to support the evolution of innovative DFS products/services and business models and test new financial products and services as the Sandbox will create an environment of experimentation and innovation within a protective legal framework.

Keywords: Digital Financial Services, Inclusive Growth, Regulatory Sandbox

Role of Digital Financial Services in Promoting Inclusive Growth in Bangladesh: Challenges and Opportunities

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1. Introduction

The Bangladesh economy has been achieving more than 6 percent real GDP growth on average for more than a decade, which has recently crossed the 7 percent landmark. One of the drivers of this stable growth is Bangladesh's success in pursuing the inclusive development strategy, supported by initiatives for socially responsible financing along with implanting these objectives into the country's financial sector. At present, the financial institutions have actively been promoting financial inclusion and green banking initiatives. The inclusive financing initiatives which allow credit to flow to the vast majority of the small farmers; micro, small, and medium enterprises (MSMEs); and other financially excluded groups/activities has helped to enhance macro-financial stability, along with incremental output on the supply side and additional employment and income generation on the demand side.

For expanding financial inclusion, Bangladesh's priority is to promote rapid access to financial services through digital pathways such that the uptake and usage of digital financial services (DFS) can be increased rapidly. In recent years, Bangladesh has also seen a growing momentum for digital financial inclusion among the government agencies and the private sector stakeholders such as banks, mobile financial services (MFS) providers, mobile network operators (MNOs) and other actors. The widespread availability of mobile phones and development of electronic payment systems have been creating alternative delivery channels to help reach the unbanked and underserved more efficiently and cost effectively. Rapid growth in mobile money customers coupled with demographic, economic, social and technological changes offer wide opportunities to accelerate the adoption of DFS in Bangladesh and expand access to and use of financial products and services to all people including women and other excluded groups.

Along with opportunities, the evolving DFS market has also its challenges. The government needs time to design a supportive policy framework and put in place enabling policy supports critical for private sector stakeholders. Evolving regulatory framework, protectionist policies, ineffective coordination with DFS providers coupled with limited supervisory capacity deter the private sector (e.g. MNOs, banks, business persons and meso level organisations) from investing in DFS. In practice, so far only a few players have taken the opportunity or made the investment needed to expand DFS. This lack of involvement consequently jeopardises the rapid growth potential of the high value DFS in Bangladesh, leaving almost 82 percent of the people without a digital account, in particular among women and small businesses. Several factors may be identified which may have contributed to restraining rapid growth of DFS in Bangladesh such as, absence of a comprehensive national financial inclusion strategy; Inadequate DFS regulatory framework; limited penetration of DFS; limited involvement of the private sector in DFS; inadequate information, knowledge and capacity; and inadequate understanding of consumers' needs.

In the above context, this study examines the role of DFS in the ongoing pursuit of inclusive growth in Bangladesh through identifying the challenges that it needs to face and opportunities that it can exploit for moving at a faster rate in realising its development goals, both efficiently and sustainably. Since digital payment systems have already taken hold in Bangladesh, there is an opportunity to work with banks and other financial service providers to increase the range of financial services that

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the excluded people (especially the poor) can access digitally. As a reasonable degree of connectivity in rural areas is already established, possibilities also exist to extend the reach of digital payment systems into rural communities and encourage the poor to adopt these systems. Public-private cooperation represents one way through which cost, distance, and regulatory complexities can be managed.

2. Financial Inclusion: Overview and Landscape in Bangladesh

The combination of a growing banking system and a large microfinance market has led to significant progress on financial inclusion in Bangladesh. In September 2016, the total number of branches of 56 scheduled banks stood at 9,464 in the country showing significant growth in the physical network of banks and ATMs in recent years; but still there exists regional disparities in the distribution of access points reflecting the natural and economic tendency to concentrate in populous and urban locations. Under the situation, the existence of the quasi-formal market helps significantly in increasing the access to financial products and services by the unbanked population especially in the rural areas. There are 697 MFIs which are licensed under the Microcredit Regulatory Authority (MRA) in 2015. According to MRA statistics, the total loan outstanding in the microfinance sector (including NGOs, Grameen Bank, state-owned commercial banks, private commercial banks, and specialised programmes of several ministries) was Tk. 504 billion in June 2015 and the volume of savings was Tk. 321 billion. The total number of clients of the sector was 34.58 million including 6.72 million clients from the Grameen Bank.[1]

In Bangladesh, indicators of both outreach and actual usage dimensions show that overall access to financial services of the population is relatively low, but has been rising fast in recent years. As per BBS data, access as a share of total population increased from 44 percent in 2005 to more than 65 percent in 2013. These figures however include multiple account holders and multiple memberships in MFIs and cooperatives. Available evidence shows that the incidence of such multiple memberships is quite high among those having access to financial services. Moreover, despite the rapidly expanding network of both formal and quasi-formal institutions in Bangladesh, informal markets continue to be widely used. This is mainly because they offer flexibility, proximity and ease of operation. Whilst the poor households have managed to deal with their lack of access to formal institutions by turning to quasi-formal providers such as MFIs, the extreme poor have far fewer options. Many extreme poor have limited access even to MFIs because they are perceived as vulnerable and therefore risky.

The 2016 Intermedia Financial Inclusion Insights (FII) Report provides helpful information on the current status of financial inclusion in Bangladesh especially relating to DFS including mobile money and the potential for their expanded use among the poor.[2] The survey findings show that financial inclusion is rising in Bangladesh driven mostly by growth in mobile money use and registration. It shows that 43 percent of the adults (38 percent women and 48 percent men) are financially included in 2015 compared with 37 percent (35 percent for women and 38 percent for men) in 2014. The extreme poor face greater obstacles in the form of geographic remoteness and illiteracy while digital inclusion is low among these groups. For policy purposes, it is important therefore to identify those households who have access to financial services and those who do not have such access. Disaggregated pictures show that the extreme poor face greater obstacles in the form of geographic remoteness and illiteracy while digital inclusion is low among these groups.

Given the need to continue to advance financial inclusion more rapidly, a pragmatic strategy for Bangladesh is to use fully developed DFS operations which will (i) reduce barriers of physical access

[1] See, MRA Annual Reports, various years, Microcredit Regulatory Authority, Dhaka.

[2] See, Inter Media, Financial Inclusion Insights—Applied Research for Digital Financial Inclusion: Bangladesh, Wave Report FII Tracker Survey, Conducted in August-September 2015, Washington DC, January 2016.

and cost; and (ii) over time enable a much higher proportion of the population to use basic formal sector deposit and payment services. Access into the formal system might eventually lead to product innovations in insurance, credit, pensions and government payments that can reach all individuals of Bangladesh. Moreover, entry to the formal financial sector will lead to greater financial intermediation which will contribute to more rapid and inclusive growth.

2.1 Advantages and Key Components of DFS

Digital financial services (DFS) refer to digital access to and use of formal financial services by the excluded and underserved populations. Moreover, such services should be suited to customers' needs, and delivered responsibly, at a cost both affordable to the customers and sustainable for the providers. There are three key components of DFS: (i) a digital transactional platform, (ii) retail agents, and (iii) use by customers and agents of a device – most commonly a mobile phone – to transact via the platform.

The benefits of digital financial inclusion for the financially excluded and underserved are many which include the following:

- Access to formal financial services--payments, transfers, savings, credit, insurance, securities and others--empower the citizens in multiple ways. Migration to account-based services typically expands over time as customers gain familiarity with and trust in the digital transactional platform. G2P payments, for example, can enable digital stored-value accounts providing a path for the financially excluded into the financial system.
- Typically, lower costs of digital transactional platforms, both to the provider and customer, allow customers to transact locally in more frequent and tiny amounts, helping them to manage their uneven income and expenses.
- Additional financial services tailored to customers' needs and financial circumstances are possible by the payment, transfer, and value storage services embedded in the digital transaction platform itself, and the data generated within it.
- Reduced risks of loss, theft, and other financial crimes posed by cash-based transactions, as well as the reduced costs relative to transactions in cash and using informal providers.
- It also promotes economic empowerment by enabling asset accumulation especially for women increasing their economic participation and welfare.

Digital financial inclusion also carries risks for the poor financially excluded and underserved customers who benefit from the opportunities:

- Novelty risks for customers due to their lack of familiarity with the products, services, and providers and their resulting vulnerability to exploitation and abuse.
- Agent-related risks due to offering of services by the new providers which may not be subjected to consumer protection provisions that apply to banks and other financial institutions.
- Digital technology-related risks which can cause disrupted service and loss of data, including payment instructions (e.g. due to dropped messages) as well as the risk of privacy or security breach resulting from digital transmittal and storage of data.

Customer uptake of DFS in many markets suggests that on balance these risks may not be perceived to outweigh the benefits of being financially included. Nonetheless, the case is strong for appropriate regulation and supervision.

2.2 State of Digital Finance in Bangladesh

In Bangladesh, a process by the financial sector and digital operators is already moving fast involving simple yet powerful innovations in the use of mobile phones. This includes introduction of digital wallet which is an electronic prepaid card with mobile banking facilities that utilises ATMs, mobile phones and other forms of e-banking. These innovations help reach a greater number of the poor and drive down transaction costs to levels that could pave the way for more effective use of financial products and applications that had previously been considered unprofitable. This may also lead to creation of saving products that are more accessible to the poor, better suit their cash flow challenges and help address future spending needs.

Bangladesh Bank, the mobile money regulator, has adopted the bank-led model with significant scope of new investments in innovation and technology. The mobile operators have already introduced many social VAS, while MFS providers have adopted various VAS in the mobile money landscape. The digital initiatives have proceeded along two fronts in Bangladesh: (i) in the banking sector through introduction of internet, SMS, ATMs and POS based transactions; and (ii) through MFS by the mobile bank account/mobile wallet. Bangladesh Bank has built a robust technology infrastructure with various enablement to support DFS such as, online credit and supervisory reporting; electronic fund transfer; Bangladesh automated clearing house; national payment switch and real-time gross settlement systems. Bangladesh Bank, in association with the NID authority, also plans to connect NID with the digital banking and MFS system to introduce e-KYC. Several initiatives have also been taken up such as NID linked G2P payments, union digital centres, agent banking; POS, rural branches, and Rural Savings Bank.

Mobile Financial Services

Bangladesh Bank issued guidelines on ‘Mobile Financial Services for Banks’ in September 2011 clearly stating a choice for the bank-led market model. However, Bangladesh Bank also advocated for making mobile operators and MFIs as active partners. The regulatory certainty allowed the market to move and by late 2011 two early leaders emerged with the largest customer bases and agent networks. The bKash services are provided by the BRAC Bank in cooperation with its subsidiary bKash; while Dutch Bangla Mobile is a service from the Dutch Bangla Bank Limited (DBBL). These two providers account for the largest shares of mobile accounts and agents. Over the last five years, MFS providers have scaled up their services and reached out to most remote corners of the country. The MFS agents are generally located much closer to customers’ homes than alternative financial service channels thus significantly reducing mobility barriers.[3]

The stated goal of Bangladesh Bank is to develop MFS as a commercially viable, safe and competitive banking channel.[4] MFS can make more points of service available and at lower costs across the banking system. An important benefit is that MFS has the potential to bring many un-banked into the formal financial sector and can also become critical infrastructure that lowers costs and raises productivity across the banking system and the wider economy.

Over the last few years since the launch of the MFS guidelines, the sector has shown significant

[3] Available statistics show that, as of 2016, there are 30 million registered customers in Bangladesh.

[4] Newly set objectives of Bangladesh Bank for modernizing country's payment and settlement systems include: establishing required legal and regulatory framework for electronic payment systems; encouraging the use of electronic funds transfer, mobile financial services, e-commerce, m-commerce, shared ATM, POS etc.; establishing national payment switch (NPS) for facilitating electronic payments originating from different delivery channels e.g. ATM, POS, Internet, mobile, etc.; establishing e-Payment gateway and real-time gross settlement (RTGS). For creating the required facilitating environment, Bangladesh Bank needs to complete these processes expeditiously including the adoption of Payments System Act.

growth.[5] As Bangladesh has adopted a bank-led model, all MFS products in the market are run by banks or their subsidiaries. The Bangladesh Bank has allowed 28 banks to offer MFS, of which 19 banks have already started to work on their MFS products in some capacity. However, only ten of them have gone operational and are providing MFS on any sort of scale. The remaining banks are still working on finalising their transaction platforms, terms of engagement with partners, business model, and strategies.

The MFS agents are the last mile delivery point for the customers. They facilitate customer registration and cash-in/cash-out transactions. Most of the providers provide a commission ranging from BDT 20-25 to agents for signing up new customers. Agents also coordinate with the branches of the partner banks to process customer documentation, although in some cases, distributors or super agents are taking over this responsibility. According to Bangladesh Bank statistics, the total number of agents was 60,000 at the beginning of 2013 which has reached more than 540,000 in February 2015.

2.3 Digital Inclusion for Women

In terms of digital finance, only 18 percent of the digital finance users are women, with fewer holding registered accounts where there exist more than 21 million registered account holders. All available information indicates that there exists significant gender divide in access to digital financial services. Addressing this involuntary exclusion by expanding women's access to MFS is a policy priority for the government and the Bangladesh Bank.

Available statistics show that less than 3 percent of the agents are women mostly due to their lower mobility and cultural barriers. Further, real and perceived security issues exist with sensitivity around sharing phone numbers with men. Digital products appealing to women are yet to hit the market and services are still dominated by P2P transfers. Phone ownership and usage is also an issue for women since the majority of low-income households tend to have one phone per household, often held by husbands or older children. The English-language phone menus also have a disproportionate impact on women since the use of Bangla text is difficult on a basic feature phone.

The factors which impact women's access to digital financial services are clearly complex, but bridging the gap is certainly possible. An important step for the providers and other stakeholders is to understand women's needs, preferences and usage of current products, services and channels. Steps are needed to engage more women as agents in places where women are comfortable in transacting, along with developing new delivery channels and products to offer. The government could promote digital government transfers and provide women greater ease of access to registered accounts by looking at innovations around identity requirements. While smart phone penetration is still relatively low, it is rapidly gaining ground. Smart phones will provide an important opportunity to improve user interfaces and address literacy barriers across all clients. However, the important aspect for the providers would be to develop responsive products meeting women's needs, potentially working in partnership with MFIs who have learned so much about serving women in great numbers.

Moreover, low financial literacy, particularly among women in the bottom-of-the-pyramid segment, poses a challenge for them in transitioning from traditional models to mobile-based platforms. In such a situation, guiding women towards the use of mobile platforms can promote their uptake and usage. In addition to addressing the systemic barriers to access and usage, the financial service providers (FSPs) need to innovate in product design and delivery. There is significant scope for current mobile-based offerings to be tailored towards the needs of specific target audiences such as women.

[5] Bangladesh Bank issued a revised version of regulatory guidelines for MFS in July 2015 which may be reviewed in the light of emerging challenges and experiences in Bangladesh and other comparable countries.

FSPs must recognise the need to create easy to use platforms that can operate on simple phones At the same time, improving the value of these products and services is important.

2.4 Challenges for Digital Inclusion of the Poor

It is well known that low-income people in Bangladesh lack the financial services they need to invest in their livelihoods, protect their assets, and avoid falling deeper into poverty. Moreover, the fact remains that the traditional financial infrastructure is too expensive to serve the poor in Bangladesh (as in other developing countries), particularly in the rural areas. However, more than 100 million people in the country have access to mobile phones, which can serve as the infrastructure to offer different financial services in a sustainable manner, such as payments, transfers, insurance, savings, and credit. Obviously, the prevailing top-down approaches, as far as banking services are concerned, needs transformation into a bottom-up approach that appreciates the perception of the poor and their needs of financial services.

For the poor, the need is to develop simple and affordable financial tools which can act as cushion during times of urgency. Electronic cash cards, agent banking, mobile phones and other digital means can create the possibility to connect rural households with reliable financial services and tools. Efforts have already been taken (under the A2i Project at the Prime Minister's Office) to support product design experiments based on behavioural insights that addresses every aspect of the system including design features, price incentives, and marketing messages leading to widespread consumption of financial services. It is imperative, however, that the services remain user-friendly, cheap and sustainable.

For mapping the landscape of payments of the government, the key issues are to: (i) identify payments that have been digitised and track changes in the shift from cash to electronic payments over time; (ii) identify ways in which the expansion of appropriate, affordable and accessible digital payments can be promoted; and (iii) explore the need of establishing a single repository of knowledge on the evolution of digital payment policy and products in Bangladesh.

The key regulatory issues raised by digital financial inclusion relate to agents, anti-money laundering and countering financing of terrorism (AML/CFT) rules, regulation of e-money, consumer protection, payment system regulation, and competition. Many of these issues fall within multiple regulators' competencies, requiring effective communication and collaboration among them.

The models of digital financial inclusion emerging in countries around the world introduce new market participants and allocate roles and risks (both existing and new) differently from the traditional approaches to retail financial service delivery. Some risks are common to most or all approaches to digital financial inclusion. The engagement of mobile network operators (MNOs), whether as e-money issuers or as a channel for a bank or similar provider, presents certain potential risks that differ from approaches without MNOs. Some risks are triggered by the model of the digital transactional platform in question. Finally, some risks relate to the provision of additional financial services beyond the payments, transfers, and value storage services offered by the digital transactional platform itself.

2.5 Developing Digital Ecosystems

It is well known that the high cost of building and operating 'brick-and-mortar' bank branches is a major constraint for extending financial services to the poor and in remote areas in Bangladesh. However, the unbanked individuals are increasingly gaining access to financial services through digital channels. Banks, MFIs, mobile operators, and third party providers are leveraging mobile phones, point-of-sale devices, along with networks of small-scale agents, to offer basic financial services at greater convenience, scale and lower cost than traditional banking allows. There is also an emerging new set of institutions such as agent networks and others who are helping to build a far reaching and efficient digital finance ecosystem. Yet, Bangladesh has a long way to go in digital

finance. Developing ecosystems are time consuming and there are barriers that hinder such progression e.g. difficulties in integrating a broader range of solutions into existing payment platforms which are costly and cumbersome and the need for accommodating physical touch points between customers and providers in many financial services such as savings and loans. Bangladesh needs to explore how it can leverage the depth and reach of existing digital payments platforms and develop a broad range of financial solutions that are relevant for the poor. In this context, several issues are important:

- Development of open payments platforms that would enable a broad range of providers to offer new solutions;
- Interoperability that would help low-income users transact more easily across digital financial services networks; and
- Digital delivery models using emerging technologies and innovations that can be used to provide services to financially excluded customer segments.

In practice, providers of financial services suited to the customers' needs and delivered responsibly at a cost both affordable to the customers and sustainable for the providers may cover four broad groups: (i) a full-service bank offering a basic or simplified transactional account for payments, transfers, and value storage via mobile device or payment card plus point-of-sale (POS) terminal; (ii) a limited-service bank offering such an account via mobile device or payment card plus POS terminal; (iii) a mobile network operator (MNO) e-money issuer; and (iv) a nonbank non-MNO e-money issuer. All four models will function using three components: a digital transactional platform, an agent network, and the customer's access device. With these components in place, payments and transfers, as well as credit, savings, insurance, and even securities, can be offered digitally to the excluded and underserved customers.

Two issues are important for efficient and healthy growth of the MFS sector. First, efforts are needed so that a sizeable number of players can take-off in this market. Second, policies are needed to promote the use of a diverse set of technologies, different kinds of agent network, and a range of products available for choice by the consumers. For pursuing the above broad vision, a number of actions may be pursued:

1. The regulators (e.g. Bangladesh Bank) should adopt prudent policies within a relatively longer term horizon and send out clear and consistent signals regarding the overall regulatory structure. This will facilitate the stakeholders to negotiate longer-term agreements. This should not, however, preclude the negotiation of incremental refinements and interpretations of the regulatory structure from time to time.
2. Bangladesh Bank should explore the possibility of promoting greater competition in the MFS market. To promote more competition and new entry, Bangladesh Bank may use several tools such as playing a more active intermediation/'honest broker' role so that MNOs and banks may bridge their differences and enter into agreements; pursuing measures that would make MFS more attractive by promoting government payments into electronic channels; encouraging donors or venture funds to invest in 3-4 fledgling banks who in future can provide real competition to the existing market leaders; and building links for MFS to connect into the national payments system.
3. As the regulator, Bangladesh Bank could seek regular market feedback from the full range of players in a systematic manner and use the process to interpret the existing guidelines to promote safe and competitive market development. The issues for consideration may include, for example, KYC standards and practices, bank and MNO branding, and use of devices other than the mobile phone such as card and POS.

Bangladesh Bank has provided a supportive regulatory environment for MFS through MFS Regulations of 2011. It provides simple and easy to implement guidelines to balance prudential

requirements with ease of mobile money account operations. As noted earlier, the MFS is at its infancy stage with heavy concentration of cash-in/cash out and P2P transactions. The full range of financial service potential of mobile money involving savings, service payment transactions, G2P payments etc. remain mostly untapped. The level of activity of existing accounts is also much below potential, with a low ratio of active to inactive accounts. So far, the Bangladesh experience with MFS is very positive, but there are several important challenges such as, low coverage relative to potential, lack of account use and product diversification, and concentration of service provider. The need for greater competition is important to take better advantage of the large untapped MFS market, promote product diversification and innovation, and reduce cost.

The present Bangladesh Bank regulations require bank-led MFS model on fiduciary grounds. The possibility of clever blending of fiduciary concerns with flexible service delivery arrangements may be explored for the future along with allowing bank MFS license holders to partner with any non-bank operator including MNOs in providing MFS services. However, the concern relating to the MNOs taking undue advantage by either restricting USSD access or setting a high price for this access for non-MNOs should be effectively addressed through regulatory requirements. The MFS expansion agenda will considerably benefit from adequate institutional coordination between the Bangladesh Bank and Bangladesh Telecommunications Regulatory Commission (BTRC). This coordination will become especially important if MNOs are allowed access to the provision of MFS.

In the context of the existence of a large NGO-MFI sector in Bangladesh, mobile financial services can open up new windows of opportunities for using MFS for the excluded groups. Although some MFIs (like BRAC, ASA) provide mobile financial services in the form of remittances, NGO-MFIs can be involved in providing different types of MFS if an enabling environment is created. The MFS industry needs to work under more prudent policy guidelines covering a number of areas, such as incentives to the users to use personal accounts in transactions; removal of insecurity problems of the agents in handling big transactions; ways to lower transaction costs, closer monitoring ML and TF issues in MFS closely.

To move forward, a number of measures need to be considered: (i) design and implement policies and measures based on consensus across all important stakeholders with emphasis on home-grown solutions; (ii) focus on stakeholder engagement, facilitation and effective coordination; (iii) adopt changes based on credible research and evidence and employing strategic communication with all key stakeholders including the policy makers: and (iv) create strong partnerships and relationships with concerned stakeholders for ensuring continuity and success.

2.6 Expanding Agent Banking Network

One of the primary impediments to providing financial services to the poor through branches and other bank-based delivery channels is the high costs inherent in these traditional banking methods. The amount of money expended by financial service providers to serve a poor customer with a small balance and conducting small transactions is simply too great to make such accounts viable. In addition, when financial service providers do not have branches that are close to the customer, the customer is less likely to use and transact with their services. In this context, we can see the emergence of new delivery models as a way to drastically change the economics of banking the poor. By using retail points as cash merchants (defined here as agent banking), banks, telecom companies, and other providers can offer services in a commercially viable way by reducing fixed costs and encouraging customers to use the services more often, thereby providing access to additional revenue sources.

Four types of agent banking delivery channels may be conceived:

1. **POS-enabled bank agent:** This is an agent managed by a bank that uses a payment card to identify customers.

2. **Mobile phone-enabled agent:** This is an agent managed by a bank that uses a cell phone to identify customers.
3. **Mobile wallet:** This is an agent that is often managed by a telecom, uses a cell phone to identify customers, and provides store-of-value accounts called mobile wallets that are backed by bank deposits. Customers can use mobile wallets to send, receive, and store electronic monetary value.
4. **Bank-provided account linked to a mobile wallet:** This is a bank account that is linked to a mobile wallet. The bank does not manage the agent and pays a fee to the telecom for deposits and withdrawals.

Empirical evidence shows that agent banking systems are up to three times cheaper to operate than branches for two reasons. First, agent banking minimises fixed costs by leveraging existing retail outlets and reducing the need for financial service providers to invest in their own infrastructure. Although agent banking incurs higher variable costs from commissions to agents and communications, fixed costs per transaction for branches are significantly higher. Second, acquisition costs are lower for mobile-enabled agents and mobile wallets. By using mobile phones instead of payment cards, mobile wallets and bank accounts linked to a mobile wallet are able to acquire customers at less than 70 percent of the cost of a branch or POS-enabled agent. In some countries, mobile wallets may also benefit from lower-cost KYC requirements, such as the elimination of requirements to provide photographs and photocopies of documents.[6] A number of other advantages are also identified for lower costs of agent banking delivery channel such as, costs are incurred only if transactions are realised, agent transaction platforms benefit from additional transactional revenue sources, and agent banking works best for low-balance, high-transaction accounts. Thus, agent transaction platforms improve the economics for the financial service providers compared with branches, especially for high-transaction, low-balance accounts that are common among the poor users. Moreover, mobile-based agents and mobile wallets are likely to push profitability frontier further than POS-enabled agents.

In Bangladesh, individuals who act as agents on behalf of banks work as customer service points (CSPs) while business correspondents (BCs) are involved in sourcing and managing one or more CSPs on behalf of banks. The use of CSPs is new although there more than half a million such points nationally. The challenges, however, are of building an active, high quality network of CSPs. Further, quality needs to become a focus in government targets, contracts and performance metrics. Support to CSPs from BC companies and banks needs to be improved and made consistent. And training, pay, regular visits and more reliable technology are needed. The key issue, along with a rapidly expanding agent networks, is also to focus on building the quality of the agent networks as the foundation of developing branchless banking in Bangladesh.

As DFS agents, women have an advantage since they are more efficient in managing liquidity, building trust and, most importantly, in on-boarding other women into DFS than men. This makes the recruitment and training of women agents an important strategy for closing the gender gaps in DFS and relevant technologies, and for ensuring universal financial inclusion. Given the growing emphasis on digital solutions to drive financial inclusion in Bangladesh, the technology gap (e.g. lower ownership of mobile phone of women than men) could further widen the gender divide in financial services, if this is not explicitly taken into account in the design of digital solutions. Recruiting women agents could be a crucial element of this design.

Bangladesh Bank issued 'Guidelines on Agent Banking for the Banks' to promote this complimentary channel to reach to the poor segment of the society as well as existing bank customers with a range of financial services especially to geographically dispersed locations. With a view to ensuring the

[6] See. How Agent Banking Changes the Economics of Small Accounts, Global Savings Forum, 2010.

safety, security and soundness of the proposed delivery channel, guidelines have been issued by the Bangladesh Bank to permit banks to be engaged in agent banking.

Overall, the guiding principle of the Bangladesh Bank should be to create a well-functioning financial system having a good mix of institutions that collectively meet the varied needs of the customers while enhancing the stability of the financial system as a whole. As the regulator, Bangladesh Bank needs to systematically evaluate available alternatives and identify the designs that hold good promise of financial inclusion and promote partnerships between different types of institutions to leverage their strengths.

2.7 Addressing Risks in Digital Systems

It needs to be recognised that most of the DFS customers are new to formal finance and have very limited space for error in their financial lives. Therefore, the 'digital journey' of the potential consumers has to be smooth and eventless in order to meet their expectations and needs. For the service providers, it is important to build trust from the mass market, large-scale uptake of services, and active usage of diverse services to get reasonable pay-off from their investments in DFS operations. Therefore, along with innovation and rapid scaling of DFS in the market, it is also important to identify the potential risks for the customers; what are the consequences of those risks for consumers, providers, and financial inclusion outcomes; and how can these risks be addressed.

An enabling policy and regulatory environment for DFS is important which includes MFS, branchless banking, electronic money, digital payment solutions and other new technologies available to promote DFS as a major driver of greater financial inclusion. For the purpose, it is necessary to identify the risk profiles of DFS business models, which is essential to designing appropriate regulatory frameworks and setting good practices in DFS.

The potential risks may emanate from a number of sources including risks arising from unreliable networks and DFS services (which can deny customers access to funds stored in their wallets or lead them to engage in unsafe behaviour e.g. giving cash and PINs for agents to transact once the service is back up), complicated and confusing customer interfaces (which also contribute to high levels of agent-assisted and OTC transactions), agent misconduct including charging of unauthorised fees, fraud of various types, and inadequate complaints handling and data privacy and protection practices.

The regulators need to explore potential industry and regulatory solutions to the likely problems in the customer journey in the DFS platform through engaging with key stakeholders along with analysing the cost effectiveness of alternative solutions. The key will be to promote 'responsible digital finance' and identify the steps that providers and other players should take to ensure that DFS are being delivered fairly, transparently and safely. It will be important for Bangladesh to learn from global experience on new frontiers in inclusive regulation, supervision and standard setting.

3. Summary and Policy Implications

Bangladesh has made significant progress towards creating a ‘digital economy’, including digitisation of payments and other financial transactions. The government has also taken steps for moving payments from cash to digital. Already, the government has started laying the foundation through regulatory and other measures while the private sector is driving the shift from cash to digital. Further progress would require continued efforts to implement measures for creating enabling conditions and evolving the regulatory environment to overcome key barriers e.g. need to ensure more competition, and wider interoperability enabling payment transactions between different service providers and platforms.

3.1 Policy and Regulatory Issues

- Ensuring the right balance between openness and innovation along with maintaining credibility and soundness of the regulatory framework.
- Regulating and safeguarding the issuance of new digital payment instruments like e-money.
- Identifying the main AML/CFT concerns in relation to digital financial services.
- Setting key principles in the supervision and oversight of digital financial services.
- Fostering interoperability and effective interconnection within different digital financial services models.
- Bringing out the implications for regulators with regard to establishing successful agent networks for bank and non-bank mobile financial services providers.
- Balancing financial stability with financial inclusion goals while developing enabling regulatory frameworks.
- Identifying key stakeholders who need to coordinate with financial regulators in order to put in place regulations that are prudential and enabling.

The central aim should be to develop MFS as a commercially viable, safe and competitive financial channel. To achieve this broad vision, healthy competition will be necessary from the wide range of providers. Two issues are important for efficient and healthy growth of the MFS sector. First, efforts are needed so that a sizeable number of players can take-off in this market. Second, policies are needed to promote the use of a diverse set of technologies, different kinds of agent network, and a range of products available for choice by the consumers.

Issue of Inactive Wallets and OTC Transactions

From the providers' point of view, maintaining inactive wallets is one of the most challenging and expensive issues. According to Bangladesh Bank, there were 31.8 million registered accounts in December 2015 of which only 13.2 million were active customers, meaning that only 42 percent of the accounts were active. Similarly, over-the-counter (OTC) mobile transactions are widely prevalent in Bangladesh despite the fact that they are not technically allowed.[7] While the regulations disallow pure OTC transactions between agents, it is silent on whether an agent can transact with a customer (partial OTC). Despite this, pure OTC transactions are still common in Bangladesh. The main reason for restricting OTC transactions is to ensure compliance with Know your Customer (KYC)/Anti-Money Laundering (AML) requirements. The sender and receiver in a pure OTC transaction are untraceable since the transaction is actually conducted entirely through agents.

There are number of reasons as to why OTC transactions are widely prevalent in Bangladesh, and this remains a challenge to address even with regulation. There are some major drivers that contribute to high use of OTC transactions such as past familiarity (e.g. money transfer services offered by courier companies), availability of informal options (for example, if an agent refuses to conduct a transaction in the absence of a mobile wallet, the customer has the option of going to an informal money transfer provider and, in the process, the agent loses a customer), incentive mismatch (agents usually charge about 2 percent of the total amount sent to make an OTC transaction whereas agents generally only receive between BDT 20-25 from the provider for each new account they open) such that it can be more profitable for the agents to encourage people to

[7] Research under the Financial Inclusion Insights programme led by InterMedia shows that MFS users are three times more likely to make a transaction OTC rather than using a registered account. They report that just over three-quarters of all MFS users in Bangladesh in 2014 are OTC users, as opposed to less than 25 percent that are registered users.

make OTC transactions, and the 'one-size-fits-all' KYC requirement from Bangladesh Bank, and the time required to open a mobile wallet. All these serve as barriers to opening an account for the users. Unlike in many other countries, Bangladesh Bank has not adopted a tiered approach to account opening with different requirements based on the transaction size. Also almost all MFS providers use an English-only USSD menu to conduct transactions. As a result, people who do not have the required level of literacy to understand English to conduct a transaction on their own often opt for using OTC.

Transaction Platform

The MFS transactions are sensitive and need to be completed immediately. The agent will not hand over the cash to a customer until he/she has received a confirmation SMS that the transaction has been completed successfully. Also, failure to complete a transaction can demotivate the customers, especially those who are using it for the first time, which may lead to formation of negative perceptions regarding the service. As is well known, the transaction platform is the foundation upon which everything else will depend; therefore, it is important to make the right technology choice at the beginning. The transaction platform works in the background and delivers functionality based on the business model and strategy of each bank. Although it is the business model and bank's capacity to execute it that determines the success of the service and not the technology, choosing the wrong platform can have a negative impact.

For example, a double PIN authentication system can be introduced so that members cannot access the savings group wallet individually. Similarly, while designing savings products for individuals, introducing 'committed' savings products are more likely to be attractive to the low income populations. These savings products could be 'goal-based' such as, to purchase a cow, for financing daughter's marriage and so on.[8] For success, one of the main challenges is the need for increased training and outreach to promote user understanding and comfort with the product. The level of support required to promote uptake of such a new product among the rural poor is obviously significantly different than urban and nonpoor mobile phone owners. Also, the coverage of mobile network and agent access has to be ensured. Further, any new mobile-based product would require significant training and outreach for which the NGO-MFIs working in the area can act as strong allies.

One of the critical issues where significant efforts are needed is on negotiating mutually beneficial partnerships between banks and MNOs. The MNOs have already opened up their USSD channels to the banks. However, several factors need careful consideration for further progress in the area. At present, the banks seem to have a regulatory advantage since Bangladesh Bank has opted for a bank-led market. In view of this, the banks have a tendency to treat the MNOs as vendors of wireless connections rather than business partners. The MNOs may not fully appreciate the regulatory risks or business case for the banks. On the other hand, the MNOs feel that they have more to offer than wireless connectivity; they have a good understanding of mass market client behaviour and skills to manage business involving millions of users. Thus there are differences in perception regarding the roles and nature of partnerships among the two major players. Under the circumstances, Bangladesh Bank needs to adopt consistent policies and adopt effective regulatory structure.

[8] There are different initiatives in other countries from which much can be learnt. For instance, Airtel Uganda has partnered with the Grameen Foundation to launch a mobile-based savings group product called Airtel Weza which aims to reduce the use of cash by savings groups, while at the same time introducing them to other benefits associated with mobile money. Airtel Weza is a group wallet that stores group funds as mobile money. It also offers mini-statements so that subscribers can see transaction summaries over a defined period. Airtel plans to allow users to link their Weza wallets to bank accounts at partnering financial institutions, thereby enabling them to access additional savings and credit products. In this case, credit would be offered to the group, rather than each individual. It would be based on the group's savings history and would be disbursed and repaid through the group Weza wallet.

There is a need for Bangladesh Bank to follow policies that actively promote greater competition in the MFS market. There are several issues around competition in the MFS market such as volume of investments, price of USSD, pricing issues; innovations for mass use; product development and value proposition; OTC and market opening for non-bank entities.

For the purpose, Bangladesh Bank may pursue a more active intermediation/'honest broker' role so that MNOs and banks can bridge their differences and enter into agreements within reasonable time. It can also pursue measures that make MFS more attractive by promoting government payments onto electronic channels. Bangladesh Bank can also encourage donors or venture funds to invest in 3-4 fledgling banks who in future can provide real competition to the existing two market leaders. Bangladesh Bank can build links for MFS to connect into the national payments system. The MFS providers may also be encouraged to make their transaction platform interoperable with their core banking system, which enables them to offer other banking products, such as loan repayments and transactions, between mobile wallets and bank accounts. For several MFS providers, a lack of capacity on the core banking system end is holding them back from offering interoperability with other banking products.

Bangladesh Bank and BTRC are the key regulators for formulating policies and regulations for mobile financial services. The MFS expansion agenda will considerably benefit from adequate institutional coordination between the Bangladesh Bank and BTRC. This coordination will become especially important if MNOs are allowed access to the provision of MFS. In this context, the creation of a more enabling policy and institutional frameworks should take into account a number of recent developments:

- There are multiple mobile money services that operate across different countries. In addition to USSD, STK and IVR services are increasingly being made available through mobile applications. This trend will continue to increase as Smartphone penetration rises.
- Although there may be competition in the market where mobile money is available, an emerging trend in different markets is to develop interoperable solutions by the mobile network operators (MNOs).
- Across different countries, it is increasingly being recognised by the regulators that the non-bank providers of mobile money services can play important roles in fostering financial inclusion and, as such, are establishing more enabling regulatory frameworks for the provision of mobile money services. For the purpose, required reforms are being enacted in different countries.[9]
- Another recent trend for the providers is to expand into related markets of mobile financial services, leveraging their strengths in mobile money, to provide mobile microinsurance, mobile savings and mobile credit to customers who do not have access to formal financial services.
- There are significant opportunities of improving and expanding the services by the mobile money providers, particularly through the development of the ecosystem. In particular, there is a need for investments in strengthening internal capabilities to address an increasing number of users and transactions through platform migrations and extension of application programming interfaces (APIs) to third party users.

Bangladesh has a long way to go to take full advantages of digital finance. The ecosystems take time to develop; and many barriers need to be removed to ensure the progression from payments to solutions 'beyond payments'. Many payments services are observed to remain closed, making the

[9] At present, in 47 out of 89 markets where mobile money is available, regulations allow both banks and non-banks to provide mobile money services in a sustainable manner.

integration of a broader range of solutions into existing payment platforms difficult and costly. In addition, many financial services such as savings and loans require multiple physical steps between the customers and the providers.

For overcoming the barriers, several steps can be explored to leverage the depth and reach of existing digital payments platforms, and develop a broad range of financial solutions that could be relevant to the poor. In line with CGAP recommendations, Bangladesh may explore several areas for adoption:

- Open application programming interfaces (APIs) to support the development of open payments platforms that would enable a broad range of providers to offer new solutions on top of the payment rails to the mass market.
- Digital delivery models through which emerging technologies and innovations can be delivered through remote, automated, fully digital delivery models to financially excluded customer segments.
- Smartphone UI/UX (user experience and user interface designs) that would allow the use of an intuitive front-end interface to enhance the user experience, while effectively communicating relevant data and influencing customer behaviour.
- Data analytics which would allow financial service providers to operationalise digital data and advanced analytics in the provision of financial services to the mass market.
- Digital finance 'plus' which would enable digital processing of small-value payments to help extend critical services and utilities, such as clean water, health, energy, and education, to previously underserved communities.

To move forward, a number of measures may be considered: (i) design and implement policies and measures based on consensus across all important stakeholders with emphasis on home-grown solutions; (ii) focus on stakeholder engagement, facilitation and effective coordination; (iii) adopt changes based on credible research and evidence and employing strategic communication with all key stakeholders including the policy makers: and (iv) create strong partnerships and relationships with concerned stakeholders for ensuring continuity and success. The approach to implementation of these measures should highlight several areas.

- **Policy Analysis and Adaptation:** Undertake an assessment of existing regulatory measures specific and/or related to DFS and MFS, and prioritise refinement issues for implementation. This should be supported by measures of capacity building of regulators to enhance institutional capacity to develop, monitor and evaluate DFS and MFS policies. If necessary, an assessment may be carried out, using appropriate diagnostic methodology, on demand, supply and regulations relating to financial inclusion using digital technologies.
- **Gathering Credible Evidence:** To share information and knowledge, credible evidence needs to be generated from existing programmes and practices of DFS/MFS including lessons learned and consumer related issues focusing on women and marginalised groups. This should be supplemented by knowledge sharing events using multiple dissemination channels.
- **Building Coalitions:** Various stakeholder engagement events, including strategic communication campaigns should be undertaken to engage key public, private and civil society stakeholders to promote and drive the DFS/MFS agendas.

For Bangladesh, providing access to high-quality financial services to all segments of the population and sectors of the economy is a key agenda. For the purpose, the following issues needs to be targeted:

- **Electronic bank account:** Each resident of Bangladesh, above the age of 18 years, should have an individual, full-service, safe and secure electronic bank account.
- **Easy access to deposit products and payment services at reasonable charges:** The number and distributional pattern of electronic payment access points should be planned in such a manner such that every citizen would have access to such a point within a reasonable distance.
- **Convenient access to a full range of formal credit products at affordable prices:** Each low income households and MSMEs should have affordable and convenient access to financial institutions (e.g. banks, MFIs and other formal credit institutions). The aim would be to raise the credit-GDP ratio at the district/division level to at least a threshold level (e.g. 10 percent) within a set time frame.
- **Access to insurance and risk management products at reasonable charges:** Each low income households and MSMEs should have convenient access to insurance (including microinsurance) and risk management products based on suitability and reasonable charges to manage risks related to life, health and disability, death of livestock and poultry, crop damage, commodity price fluctuations, damage to property (e.g. dwellings due to floods and cyclones) and other unexpected events due to natural and/or manmade disasters.

For guarding against large scale defaults resulting from catastrophic events, banks may be permitted closely with insurance companies to purchase bank-wise portfolio level insurance against events like floods or disasters on a regional/national basis. For encouraging the formal financial institutions (e.g. banks) to provide financial services to disadvantaged locations and the poor and financially excluded groups, these locations and groups may be provided with weights based on providing services to these groups and locations. Under the system, the financial institution may benefit from the multiplier value associated with the particular group/location. This will enable the financial institutions to develop greater regional and sectoral specialisation among them.

There is a need to develop a robust legal and regulatory framework for the customer data generated through various transactions (e.g. payments and credit, digital and others) with the objective of ensuring customer ownership and its use in establishing creditworthiness and other purposes. The Bangladesh Bank may develop a framework for sharing of data among the financial institutions, telecom and utility companies, credit bureaus and others. Similarly, universal reporting to credit bureaus has to be mandated for all loans, both individual and institutional.

Bangladesh Bank may explore the pros and cons of different types of banking system design using the functional building blocks of payments, deposits and credit. For example, these may include: national banks with branches, national banks with agents; regional banks; payments banks; payments network operators and similar other models. On the basis of a set of comprehensive analysis, Bangladesh Bank may, for example, provide licenses to a set of banks to operate as payments banks adhering to rules and regulations framed by the Bangladesh Bank. Similarly, for creating integrated providers of financial services, Bangladesh Bank may circulate comprehensive guidelines for appointing agents along with eligibility criteria for the agents.

Adequate access to affordable credit requires comprehensive actions in a number of directions to actively manage the flow of credit to the excluded households/sectors. Along with steps for encouraging the banks to enhance their credit exposure to low income households and MSMEs, universal reporting to credit bureaus may be mandated for all loans, both individual and institutional. For moving forward, Bangladesh Bank could frame a clear and detailed vision for financial inclusion and deepening including a set of design principles to guide the development of institutional frameworks and regulations, strategies to address specific barriers, and a comprehensive monitoring framework to track progress.

There is also a need to articulate a clear vision, establish a set of design principles and adopt appropriate strategies for reaching the financial inclusion goals. In view of the wide diversity across geographic, socioeconomic, and other characteristics, it needs also to be recognised that a single approach to financial inclusion is not likely to serve all groups of population and locations. At the same time, the financial inclusion goals are needed to be pursued in a manner that does not threaten the stability of the financial system, for example, by building up high levels of non-performing assets or impairing the profitability of the financial institutions.

In view of the sheer size of the financially excluded adults (about 77 million) in the country, along with the use of more efficient non-branch but cash-based channels (e.g. ATMs and business correspondents), financial inclusion and efficiency gains through widespread use of electronic money will be important for Bangladesh. For the purpose, effective measures should be designed to make access to formal electronic payments infrastructure universal as a key component of the overall vision of financial inclusion and ultimate transition to a 'less-cash society' in Bangladesh. In this context, Bangladesh Bank should also examine whether the key role of bank-led strategies needs supplementary development of new ways of harnessing the capabilities of non-bank institutions including creating a level playing field for both financial and non-financial institutions. In particular, in low-revenue rural areas where the banks face significant challenges in spreading financial inclusion, nonbank players (e.g. telecommunication companies) have bigger customer bases and significantly deeper presence and they would be able to add significant incremental value to financial inclusion.

Promoting Financial Integrity

The implementation of DFS measures will have to go hand-in-hand with measures for promoting financial integrity. The financial inclusion and an effective financial integrity regime will have to be taken as complementary for which comprehensive measures are needed to develop effective financial integrity including Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) standards. Moreover, appropriate implementation of the AML/CFT safeguards will be ensured such that low income people are not excluded from formal financial services and relegated to the informal world of cash.

The Bangladesh Financial Intelligence Unit (BFIU), in collaboration with the World Bank, has already initiated actions for developing the Financial Inclusion Product Risk Assessment (FIRA) which will assess the money laundering/terrorist financing (ML/TF) risks associated with particular financial inclusion products such as farmers' accounts, student banking and mobile financial services. In the case where a specific product is found to have high risk, the features, functions and mitigation mechanisms of the product will be modified to reduce its risk level. The efforts are also directed to explore opportunities for leveraging the National ID database for streamlining and simplifying the CDD process using eKYC.

3.2 Some Policy Issues

A number of areas would require specific courses of action to help increase interest in and uptake of DFS in Bangladesh. As shown in this study, there is a need to overcome a number of barriers, for which appropriate actions have to be considered by different parties in the ecosystem. Increased use of DFS by the government for G2P payments would certainly help to drive significant uptake, and potentially drive down costs and diversify service offerings.[10] The DFS service providers should consider expanding their awareness raising efforts to promote their full suite of services— not just

[10] One A2i-CGAP study in 2015 shows that the potential benefits of G2P digitisation can be quite large. For the six major safety nets programmes, through shifting limited purpose accounts to real accounts and digitising the back-end approval process, the beneficiaries can make 58 percent savings in time, 30 percent savings in cost and 80 percent savings in visits. On the other hand, the government can make 10 percent savings in expenses along with improved perception of the government and enhanced trust.

P2P transfers.

In addition, DFS providers need to improve their agent training programmes to ensure that agents are better equipped to train customers on how to use these services. This includes not only basic awareness and training of how to use services, but also on their rights as customers, knowledge of standard pricing (and how to deal with agents who try to charge them extra), keeping their accounts secure (i.e. not sharing their PIN), and the value of using DFS beyond just cash-in, cash-out, and P2P transfers. In addition, particular attention should be paid to communicating the true cost of DFS as compared to other means, when other factors such as travel costs and wasted time are included.

One potential entry point to promoting DFS as more than just a money transfer mechanism could be to promote its use as a savings instrument. This would also help to reduce the incidence of OTC transactions, and increase financial inclusion, as people begin to see DFS as being more than just a transfer service.

In addition to expanding payment options, the possibility of introducing mobile-based credit services should also be explored. Limited access to credit from formal financial institutions especially among the rural poor points out that there is potential for credit risk analysis and scoring using mobile phone usage data. This type of mobile-based scoring is already being done in several markets globally, both by MFS providers directly (such as M-Shwariin Kenya) and third-party providers (such as in Venture). Introducing similar types of credit scoring services and micro-loan products tied to mobile wallets in Bangladesh could help to bridge the gap in formal credit access.

Given the huge investments necessary to launch the agent networks and P2P transfer services, it is not surprising that most of the DFS providers move slowly into the payments and credit space. This presents an opportunity for third-party providers to step in to make the required investments, such as for example, to build out a merchant network.

Available evidence suggests that gaps between male and female access to mobile phones and DFS exist in Bangladesh; women have lower access to mobile phones and financial services. The potential scope to increase financial inclusion of women via the use of DFS is wide. On the service provider side, these can be addressed partially through the use of user-centred design approaches to developing marketing and products that are more tailored to the needs of women. For instance, providers may explore promoting the increased security and convenience of DFS over cash for making payments often conducted by women (such as paying school fees) to help increase the perceived value of opening an account. Providers can develop digital financial literacy trainings and materials that appeal specifically to women (Axis Bank and Airtel Money in India have taken such programmes). In addition, recruiting more female agents may help to increase comfort levels that women have with using their services.

On the implementing partner side, this can be done through targeted efforts at awareness raising and training on the benefits of DFS for women, aimed at both women and their gatekeepers, to reduce access barriers. The IPs can also support women's access to DFS by making organisational switch. Although the current regulations in Bangladesh have created a reasonably supportive environment conducive to DFS growth, there exist some areas where regulations can be further improved.

- Allowing for a tiered KYC system, whereby low value accounts require less documentation than higher value accounts, could help to encourage the opening of MFS accounts, particularly at the base of the pyramid. The creation of a national KYC database including relevant national ID database information could speed up the KYC process by giving MFS providers quicker access to information needed to verify customers. MFS providers should also be able to check whether an individual has already been verified through the KYC process conducted by another provider so that they can immediately approve accounts in those instances.

- Allowing for small transactions to be made immediately after an account is opened, but before it is activated, instead of having to wait up to a week before any transactions can be made, might promote account opening and reduce consumer reliance on OTCs. With the potential for all 28 banks that have already received MFS licenses to eventually have products on the market, regulators may at some point need to consider whether they want to play a role in encouraging or mandating interoperability as well. As it currently stands, it is not possible to send money from an account on one MFS provider to an account on another MFS provider (i.e. to send money from a bKash to a DBBL account).
- Some of the challenges that exist in regards to MFS providers' dependence on using mobile phone channels, such as USSD, may require continued coordination between Bangladesh Bank and BTRC to ensure that both parties concerns are adequately addressed in a way that will maximise the quality and dependability of MFS products in Bangla.
- It requires big investment to set-up the DFS proposition and to scale up operations. Given that it is a longer term investment compared with other banking services, smaller banks are hesitant to come into the DFS space. Some of the banks who have received permission from Bangladesh Bank are still undecided as to whether they will launch their service due to the cost factor. One possible solution for banks who are interested to come into the DFS space is to form a consortium and have one bank providing fully managed services to reduce the investment cost by the partner banks. This would allow other banks to focus on only business aspects and operational roll out. Given that banks in a consortium will be connected to one transaction platform, it will be able facilitate interoperability at customer level as well as agent level.
- While having a Bangla menu can help promote direct customer-to-customer transactions but that alone cannot curb OTC. The current structure incentivises agents to push clients to cash-out full amounts and to perpetuate OTC. Literacy of clients is the key factor that will help them understand the disadvantages of OTC and prompt them to move to direct transactions. Increased compliance can also reduce OTC.

For creating a well-functioning and satisfactory DFS regulatory framework, greater insights are needed on the current DFS/MFS regulations and existing barriers in the regulatory framework.

- **A vision of DFS**

There is a need to set a well-articulated vision of DFS. The presence of multiple and sometimes less clear regulatory guidelines discourages the providers to act, experiment, expand and develop DFS services. Till now, except only a few, the majority of the MFS providers have witnessed slow growth and many have not even gone ahead in introducing their products despite having a licence from Bangladesh Bank.

- **Comprehensive review of MFS guidelines and agency banking guidelines**

The aim is to define the scope of MFS accounts which will dictate the design of other regulatory frameworks, remove confusions and make the scope of market expansion visible to the market players. More specifically, Bangladesh Bank may like to review several specific areas: (i) alignment of policies such as conflicting provisions between agency banking and MFS; (ii) possibility of prescribing unified and aligned provisions under respective regulatory frameworks such as KYC, licensing requirements, reporting requirements etc.; (iii) introduce a robust KYC standard that would ensure better customer verification and be convenient to the customers (e.g. introduction of tiered KYC system, allowing e-KYC, harmonising KYC requirements across banks, telcos, MFS providers and other related entities); (iv) identify common protocols for providers for reference/use of national

assets (such as NID/other identities; interface design and customer protection); (v) set guidelines on managing agent networks and on standard operating procedures (SoP) for agents; (vi) identify ways through which MNOs could participate more effectively in the market; and (vii) examine the issue of re-defining norms for pricing and accessibility of USSD with the objective of creating a level playing field and setting minimum quality standards and pricing rules (e.g. USSD prices are applied in a non-discriminatory fashion) to foster healthier competition.for the providers in DFS space.

- **Space in MFS and agency banking regulations for testing products and services**

Regulations are needed to allow for innovation and testing in order to enable the development of more customer friendly products such that the providers can offer different products for increasing DFS use. For the purpose, Bangladesh Bank needs to create enabling conditions such that the providers can test savings, deposit, credit and insurance products preferably within a controlled environment. This can be done through executive mentoring of service providers by conducting dialogues and interactions with relevant groups; encouraging providers to develop better interfaces through testing new products; creating avenues of digital money by encouraging employers in both formal and informal sectors to give payments to employees in bank accounts; incentivising banks and providers to create a digital driven local economy especially in rural and far-flung areas and digitising all points in the payment flows value chain to induce people to adopt and use digital money; and adopting wider use of G2P means of transfers.

- **Capacity building on interoperability**

Bangladesh Bank needs to set its vision for interoperability through identifying the degree of interoperability needed in Bangladesh and exploring different frameworks/toolkits on interoperability. Several issues are relevant such as, types of interoperability (full scale, account to account, account to wallet etc.) and pros and cons of each model; membership of all banks in the national switch within a time bound manner; and linking MFS with national switch to realise the full benefits of MFS for remote payments and encourage customers to shift from OTC to self-conducted transactions.

- **A risk management framework aligned to global industry standards**

Bangladesh Bank needs to put in place a risk management framework in alignment with the adopted DFS vision for the country. There will be new and varied players like shared agent network providers in practice or a specialised class of players who offer data analytics plus agent management services or a class of MFIs working as DFS providers or partnering with a bank as service channel. This also means that Bangladesh Bank needs to build capacities to manage such players/use of players by providers and assess the risks, if any, that these players bring, and how these risks can be managed.

- **Adoption of supervision protocols**

Based on its enhanced capacities and looking at best practices in similar DFS environments, Bangladesh Bank needs to develop tools to monitor the efficacy of agent level operations; issue supervision guidelines outlining systemic, departmental supervision and, if needed, agent based supervision; recommend common protocols for providers such as the use of NID for KYC verification, guidelines on interface design including Bangla language requirements, customer protection norms etc and ensure that the providers have the vision, systems and training to innovate and develop DFS.

- **Promoting innovation whilst managing risks**

Bangladesh Bank's guidelines for DFS need not only to enable and foster innovation, but also to develop tools and techniques for increasing competition and managing risks. The framework must ensure the right balance between these two considerations.

For promoting inclusive growth, DFS needs to combine the benefits derived by the unserved or underserved clients through access to quality financial services with a commitment to sustainability by the providers so that access to services can be sustained over time and offered to growing numbers of clients, especially because these clients are potentially vulnerable. The providers and

other industry stakeholders must focus on the need to deliver services that are safe, offer good value for money, and are likely to generate benefits for the poor clients. For the purpose, three issues are important: (i) financial regulators need to set and enforce rules to ensure that retail services are offered transparently, that providers treat customers fairly and do not put them at risk, and that effective mechanisms exist to address customer complaints; (ii) DFS providers need to improve product design and services including standards and codes of conduct; and (iii) interventions are implemented that raise consumers' awareness and strengthen their financial capability helping them to behave responsibly and protect themselves. The government, including the regulators, need to play the critical role in creating incentives for and supporting responsible practice by DFS providers. The guiding principles are to ensure improved retail-level practices and products, consumer protection regulation and supervision, and consumer financial capability.

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The Institute for Inclusive Finance and Development (InM) is working since 1 January 2016 as a non-profit organisation established primarily to meet the research and training needs of national as well as global financial sector including microfinance institutions (MFIs). Its predecessor, Institute of Microfinance, was established at the initiative of the Palli Karma-Sahayak Foundation (PKSF) on 1 November 2006. The InM is registered as an independent non-profit institution under the Societies Registration Act 1860. The Institute works for developing the overall capacity of the financial sector and strengthening the links between the financial and real sectors through undertaking research, training, education, knowledge management and other programmes in priority areas including microfinance, inclusive finance, poverty and development.

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