



## The Inclusion Economy

### Championing financial access and safety

With regulatory penalties and skyrocketing compliance costs, many international banks have chosen to reduce their exposure to higher risk markets. This retreat has had the unintended consequence of financial [exclusion](#), starving some emerging markets of access to critical financial services and currencies like the US Dollar. The impact has been substantial.

It is estimated that nearly 2 billion working age adults globally do not have access to an account at a financial institution or a mobile money provider. The size of the 'unbanked' population is staggering, but is perhaps most severe to the developing world as we observe data and trends from the correspondent banking retreat.

Correspondent banking relationships, where a financial institution provides services on behalf of another bank to facilitate cross-border payments (typically trade finance, cash, foreign exchange), have declined globally by as much as 25 percent by some estimates over the last 10 years<sup>1</sup> despite the fact that global GDP per capita grew during the same period.

While many of the countries in the developing world have substantial populations and expanding economies that are ripe for financial services and products, they also carry serious financial crime risks. The myriad financial crime risks, skyrocketing compliance costs, and a steadily decreasing risk tolerance for risk have led banks to retreat from these countries.

Sadly, this is a harsh reality faced by banks located in developing countries looking to the global financial system for access. It is increasingly common for global correspondent banks to withdraw from markets citing "off-strategy issues" and compliance costs outweighing business value. Making matters more painful is that these exits are happening at the same time as regulators and NGOs agree that correspondent de-risking needs to be reversed because of the impact on financial inclusion.

Where does this put the developing world and their local banks? More importantly, what does this mean for the individuals and businesses who are cut off from reliable access to the global financial system?

[The answer: individuals and businesses are forced into grey and black market financial services schemes.](#)

Informal value transfer systems (e.g. Hawala) and non-standard lenders (e.g. loan sharks) are some of the most obvious alternatives available. But, these alternatives are

unregulated, have no consumer protections, and tend to be more costly. Further exacerbating these challenges is the fact that in most parts of the world where such grey and black markets thrive, the legal system is often tenuous. This leaves little chance for redress when fraud is perpetrated. Victims remain victims, and the financial exclusion cycle continues.

The case of Afghanistan represents a sobering example of a country under threat to be excluded from the formal financial system.

For Afghanistan International Bank (AIB), a bank that represents a critical gateway for a population of 33 million, there would be virtually no direct (or legal) link to the global financial system and access to critical Dollars, Sterling, and Euro. As Afghanistan has virtually no manufacturing of its own, most goods need to be imported – from cars, to cigarettes to baby formula – and AIB handles around 80 percent of outward dollar payments for these imported goods.

According to the World Bank<sup>2</sup>, Afghanistan is still a country which faces serious security, corruption, and geopolitical challenges. In such a fragile situation, one would not expect to find a financially stable, privately owned bank, much less a bank so intensely focused on financial crime compliance excellence.

Compared to many other banking organisations located in so-called safer markets, AIB's culture of compliance and grasp of financial crime requirements deserves attention and recognition.

Unfortunately for both Afghanistan and AIB, recognition for their advanced financial crime compliance programme and their investments have not managed to persuade many global banks to retain or establish a relationship with them.

**For global correspondents, many of whom have been coping with prolonged regulatory enforcement actions, the decision to exit many parts of the developing world is unsurprising. The pressures are clear and building:**

**1. Downward pressure on transaction fees.** To stay competitive, not just with banks but with other new entrants like payments companies and other FinTechs, there is industry-wide pressure building to reduce transaction fees. There is even talk about how to make a USD1 transaction fee profitable.

**2. More clinical approach to markets and products.** Many global banks have had to contend with significant regulatory penalties and while many are nearing the completion of their regulator-mandated transformations, geographic risk appetite and uncertain business dynamics have resulted in a much lower risk tolerance for higher risk, developing world countries like Afghanistan. Business is business and if the numbers do not work, the local bank may ultimately be cut-off.

**3. Compliance costs continue to skyrocket.** Maintaining any banking relationship is an expensive and a highly manual endeavour performed yearly. This burdensome activity is further amplified when dealing with high risk respondent banks operating in high risk countries. Costs have been known to exceed USD50,000 annually for just one relationship.

While many higher risk countries do face serious financial crime risks resulting from years of war, regular political turmoil, and nascent legal and regulatory institutions, there are numerous advantages and real opportunities for financial services institutions to promote trade and commerce within a safe and regulated environment for consumers and businesses across the developing world. Recent advances in FinTech and the ubiquity of mobile banking are beginning to reshape the overall banking narrative, particularly the financial inclusion perspective. And from these advances, there have emerged a number of innovative approaches that can actually allow global banks to 'bank the unbanked' through smarter correspondent banking that can reduce risk and cost.

Deloitte and FinTech entities have teamed up to tackle the issue of financial inclusion and the retreat of correspondent banking.

**Our proposition - 'The Inclusion Economy' – is a digital Know-Your-Customer and Know-Your-Transaction 'credentialing' ecosystem which we hope can help reverse the decline in correspondent banking and the resultant financial exclusion.**

The objective of our proposition is simple: Make it safer and less expensive to maintain correspondent banking relationships.

The current correspondent banking retreat from the developing world by global correspondent banks can be reversed by reducing the prohibitive compliance costs associated with maintaining relationships in high-risk markets, and also help to guide the development and improvement of respondent banks' compliance programmes raising them to an "acceptable" standard.

Banks have been "deputised" by global regulators to serve as the guardians of the financial system. While this is a noble aspiration, it requires significant investment to execute well, and is too often weighed down by operational process and compliance cost. Inevitably, it often results in the marginalisation of some banks in locations most in need.

We need help reverse this trend. Please contact us to learn more about 'The Inclusion Economy' and how we can collaborate.

Notes:

<sup>1</sup> Deloitte Analysis of the following sources: "New correspondent banking data - the decline continues", Bank of International Settlements, 2018 ([https://www.bis.org/cpmi/paysysinfo/corr\\_bank\\_data/corr\\_bank\\_data\\_commentary\\_1905.htm](https://www.bis.org/cpmi/paysysinfo/corr_bank_data/corr_bank_data_commentary_1905.htm)); "Global Findex database", The World Bank, 2017 (<https://globalfindex.worldbank.org/>); "GDP Annual Growth", The World Bank, 2019 ([data.worldbank.org](http://data.worldbank.org))

<sup>2</sup> The World Bank, (<https://www.worldbank.org/en/country/afghanistan/overview>)

This document is an executive summary of a Deloitte whitepaper entitled "The Inclusion Economy: Reaching the unbanked by championing financial access through technology" that features a Know-Your-Customer and Know-Your-Transaction ecosystem enabled by identity. Know-Your-Transaction (KYT) enables you to know more about each and every transaction, to enable previously high-risk partners and banking channels to remain open. It also includes a unique case study on an Afghan bank and their journey toward financial inclusion.

The full whitepaper will be released in November 2019.

## Contact us

**Tim Phillipps**

**APAC Financial Crime Advisory Leader**

tphillipps@deloitte.com

**Andrew McCarthy**

**APAC Financial Crime Advisory Partner**

amccarthy@deloitte.com

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